S. Hrg. 101-548

TO AMEND THE BANKRUPTCY CODE

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

S. 544

A BILL TO LIMIT THE MODIFICATION OF COLLECTIVE BARGAINING AGREEMENTS SUBJECT TO THE RAILWAY LABOR ACT

MARCH 17, 1989

Serial No. J-101-5

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TO AMEND THE BANKRUPTCY CODE—S. 544

FRIDAY, MARCH 17, 1989

U.S. Senate,
Committee on the Judiciary,
Washington, DC.

The committee met, pursuant to notice, at 9:30 a.m., in room 226, Dirksen Senate Office Building, Hon. Howard M. Metzenbaum presiding.

Present: Senators Biden, chairman of full committee; Metzenbaum, Simon, Thurmond, and Specter.

OPENING STATEMENT OF SENATOR METZENBAUM

Senator Metzenbaum. The hearing will come to order. Good morning. Today's hearing is on S. 544, a bill to amend the Bankruptcy Code to protect employees and creditors of the airline industry. Eastern Airlines' filing for bankruptcy has made this bill both timely and necessary.

[The bill and summary follow:]

II

101st CONGRESS
1st Session

S. 544

To limit the modification of collective bargaining agreements subject to the Railway Labor Act.

IN THE SENATE OF THE UNITED STATES

March 8 (legislative day, January 3), 1989

Mr. **Metzenbaum** introduced the following bill; which was read twice and referred to the Committee on the Judiciary

---

A BILL

To limit the modification of collective bargaining agreements subject to the Railway Labor Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 103(g) of title 11, United States Code, is amended by inserting before the period the following: ", except for section 1167, which shall apply to any collective bargaining agreement subject to the Railway Labor Act (45 U.S.C. 151 et seq.)".

Sec. 2. Section 1113(a) of title 11, United States Code, is amended by striking out "other than a trustee in a case covered by subchapter IV of this chapter and by title I of" and insert in lieu thereof "other than a debtor in possession or trustee in a case covered by".

SEC. 3. Section 1167 of title 11, United States Code, is amended by striking out "neither the court" and insert in lieu thereof "neither the court, the debtor in possession,".

SEC. 4. Section 109(d) of title 11, United States Code, is amended by—

(1) redesignating subsection (d) as subsection (d)(1); and

(2) inserting the following at the end thereof:

"(2) A common carrier by air engaged in interstate or foreign commerce as described in section 181, First of the Railway Labor Act (45 U.S.C. 181) shall be a debtor under chapter 11 of this title only if every member of such carrier's controlled group of corporations simultaneously becomes a debtor under chapter 11 of this title. Such carrier and the members of its controlled group shall be deemed substantively consolidated upon the commencement of the chapter 11 cases. A carrier's controlled group of corporations shall be defined by section 1563(a) of the Internal Revenue Code of 1986, except that the term '30 percent' shall be substituted for the term '80 percent' in such section.".

SEC. 5. This Act and the amendments made by this Act shall be effective on March 8, 1989, and shall apply to any case or proceeding filed on or after such date.

○

Summary of S. 544 -- A Bill to Amend the Bankruptcy Code Relating to Rights of Employees and Creditors of Bankrupt Airlines

S. 544 amends the Bankruptcy Code to protect the rights of employees and creditors of bankrupt airlines. Since enactment of the Airline Deregulation Act in October 1978, 78 airlines, including such major carriers as Braniff, Air Florida, Continental, Frontier and now Eastern have filed for bankruptcy. One important lesson of those bankruptcies is that employees and creditors have great difficulty protecting their rights. This bill makes for a more level playing field between the debtor airline and its employees and creditors.

The bill amends section 1167 of the Bankruptcy Code to correct an overly-restrictive judicial interpretation of that section. The Railway Labor Act (RLA) controls resolution of labor disputes in both the railroad and airline industries. Section 1167 accepts the RLA control in this area: labor disputes involving bankrupt railroads are resolved through RLA procedures, rather than by the bankruptcy court judge. Since 1934, when the RLA was extended to cover the airline industry, railroad employees and airline employees have been subject to the same procedures for resolving labor disputes. But courts have interpreted section 1167 as limited only to railroad employees. S. 544 corrects this inconsistency in the law by clarifying that section 1167 applies to airline employees as well as railroad employees.

The bill also amends section 109 of the Bankruptcy Code to reflect the realities of the corporate structure in the modern airline industry. Those realities are that as air carriers have swallowed-up competitors in a deregulated industry, they have developed complex corporate arrangements that can be used to shield airline assets from the reach of creditors. Parent holding companies and related subsidiaries should not be able to drain cash and assets from the airline corporations so as to leave creditors holding an empty bag. S. 544 corrects this problem by providing that if an air carrier files for bankruptcy, then the parent holding company and other entities that are part of the carrier's "controlled group" must enter bankruptcy. ERISA already relies on "controlled group" assets for pension liability purposes. This bill extends that concept to creditors of bankrupt airlines. The definition of "controlled group" is patterned after the existing tax code provision.

This bill was introduced on March 8, 1989, one day before Eastern filed for bankruptcy. If enacted, the law would apply to the Eastern bankruptcy. But it is not limited to the Eastern bankruptcy. It applies to the entire airline industry, to all airline employees and to all airline creditors. Given the history of airline bankruptcies and the potential disruption from future airline bankruptcies this industry-wide reform is both timely and necessary.

Senator METZENBAUM. We will hear from a number of witnesses today. I welcome the airline employee representatives, airline industry officials, and a panel of knowledgeable experts.

I regret that there is one group we will not hear from today, the airline creditors. I am not so worried about the sophisticated creditors like General Electric or IBM or Marriott. They have the resources to take care of their interests. What concerns me most is the average ticketholder who has become a reluctant and unsuspecting creditor. Out of the blue they suddenly realized that they had tickets, that they were owed money from Eastern, and they had no recourse. It is not enough that they have been stranded in airports, their dream vacations or business trips ruined, but they are now stuck holding a piece of paper, millions of dollars of prepaid tickets that probably are not worth the paper they are printed upon.

I read something about what Eastern is willing to do so that Eastern tickets retain up to 25 percent of their value. I am not even certain what Eastern can do. One thing I know should be done with those creditors. Someone ought to advise them not to pay their credit companies, whether it's American Express or Master Charge, or whatever the other names are, someone ought to advise them not to pay, and they ought to, at the same time, demand a refund from Eastern. I believe it would protect their position with respect to their credit charges and the question of whether or not they would have to pay for them.

I'm concerned about people like Lauren Rosendorf of Virginia, who has been caught in the middle of the Eastern bankruptcy. She bought $940 in Eastern tickets in December for a planned family vacation to Florida in April. She cannot seek a refund because Eastern will not announce if the flights are canceled. She has not been able to make alternative flight plans. And her family will drive to Florida, cutting short their vacation. As a small unsecured creditor, she has little chance of ever recovering her $940. And, in order to do so, she probably would have to spend more than that in legal fees.

I wish that were an isolated incident. But it happens to thousands of consumers whenever an airline goes bankrupt. In modern airline bankruptcies, consumers and workers get the short end of the stick.

Unfortunately, since deregulation, airline bankruptcies are a frequent occurrence. Eastern is the 78th airline bankruptcy since 1979. This bill may have been precipitated by Eastern's bankruptcy, but it is not limited to Eastern, nor was it ever intended to be so limited.

My bill will give workers, consumers, and creditors a fighting chance to salvage their fair share in an airline bankruptcy proceeding.

Before we hear from today's witnesses, and the ranking member of this committee, I would like to put this problem in some perspective.

A look at the five largest bankruptcies since deregulation—Braniff, Air Florida, Continental, Frontier, and Eastern—will show what is at stake. The numbers indicate the number of employees whose jobs were lost and impacted.

As you can see from that chart, tens of thousands of workers have been affected by large airline bankruptcies. The numbers range from over 1,900 workers at Air Florida to over 30,000 workers at Eastern. This chart does not include the thousands of workers involved in the 73 other airline bankruptcies.

Now, the second chart—I'll ask somebody to remove the first one—the second chart illustrates the stakes for unsecured creditors. This group of creditors includes trade suppliers, ticketholders, travel agents, and employees. As the chart demonstrates, these five bankruptcies alone produced nearly $3 billion in unsecured debt. Unsecured creditors are particular vulnerable when the airline has been transferring assets in cash through a visiting maze of corporate holding companies and related entities. That chart over here, that chart gives you a good example of what we're talking about. It illustrates one such maze, it's what the Wall Street Journal called "Frank Lorenzo's House of Mirrors."

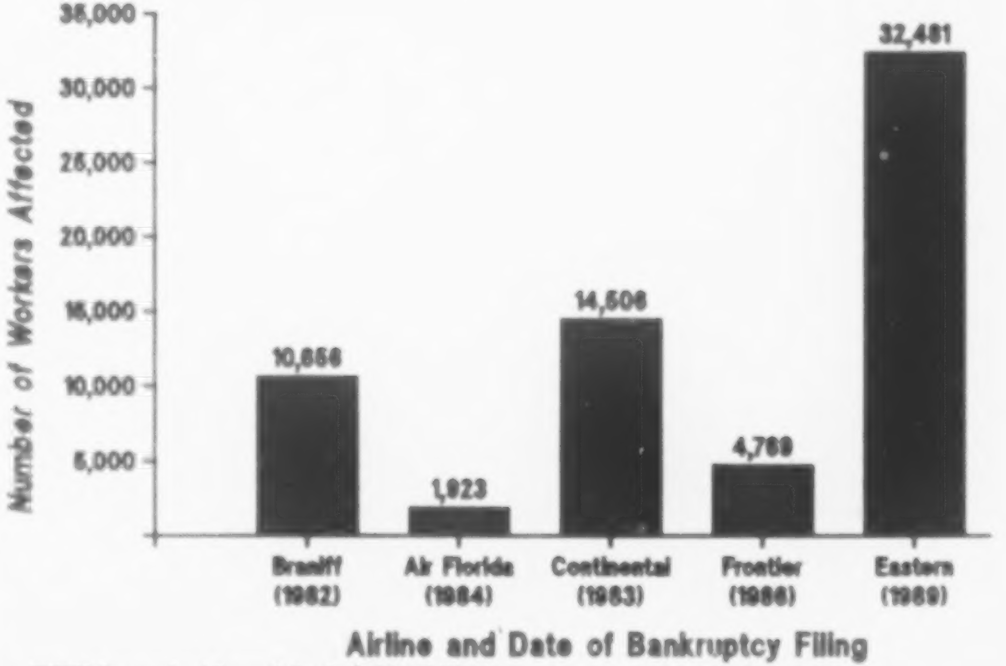
According to the Journal, Lorenzo was able to pile up huge losses in debts in the airline entities, while upstreaming millions of dollars to parent-holding companies through loans, fees, cash, and asset transfers.

And what has been occurring is the money has been moving up from the subsidiaries to the parent corporation. The assets have been moving up. The sale of locations at various airports have been transferred from one to the other. And so that is one of the major reasons why in order for this matter to be met squarely, you need that aspect of the legislation which has to do with the corporations' parent and affiliated companies being subjected to the creditors.

I might say parenthetically that part of the bill is exactly the same language as that which is to be found in the ERISA law.

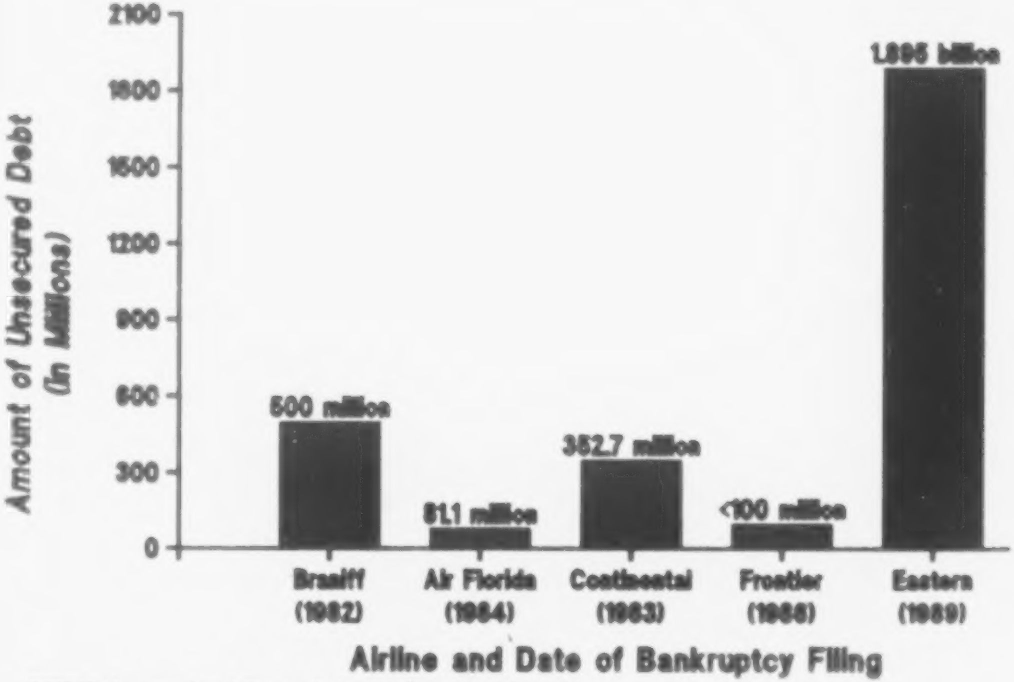
[The charts follow:]

WORKPLACE IMPACT: NUMBER OF EMPLOYEES AFFECTED BY 5 LARGEST AIRLINE BANKRUPTCIES SINCE DEREGULATION



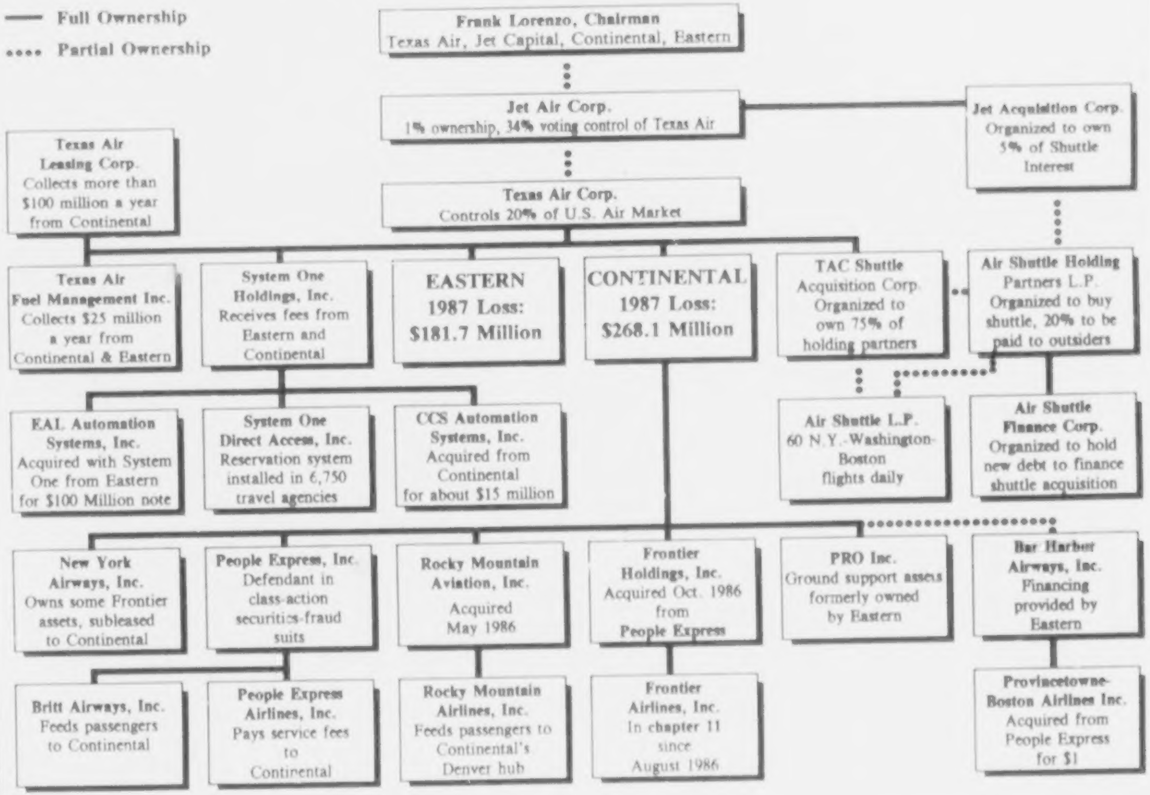
SOURCE: Congressional Research Service/Published Reports

A SEA OF RED INK: AMOUNT OF UNSECURED DEBT IN THE 5 LARGEST AIRLINE BANKRUPTCIES SINCE DEREGULATION



SOURCE: Congressional Research Service/Published Reports

The House That Frank Lorenzo Built


— Full Ownership
•••• Partial Ownership
Frank Lorenzo, Chairman
Texas Air, Jet Capital, Continental, Eastern
Jet Air Corp.
1% ownership, 34% voting control of Texas Air
Jet Acquisition Corp.
Organized to own 5% of Shuttle Interest
Texas Air Leasing Corp.
Collects more than $100 million a year from Continental
Texas Air Corp.
Controls 20% of U.S. Air Market
Texas Air Fuel Management Inc.
Collects $25 million a year from Continental & Eastern
System One Holdings, Inc.
Receives fees from Eastern and Continental
EASTERN
1987 Loss:
$181.7 Million
CONTINENTAL
1987 Loss:
$268.1 Million
TAC Shuttle Acquisition Corp.
Organized to own 75% of holding partners
Air Shuttle Holding Partners L.P.
Organized to buy shuttle, 20% to be paid to outsiders
EAL Automation Systems, Inc.
Acquired with System One from Eastern for $100 Million note
System One Direct Access, Inc.
Reservation system installed in 6,750 travel agencies
CCS Automation Systems, Inc.
Acquired from Continental for about $15 million
Air Shuttle L.P.
60 N.Y.-Washington-Boston flights daily
Air Shuttle Finance Corp.
Organized to hold new debt to finance shuttle acquisition
New York Airways, Inc.
Owns some Frontier assets, subleased to Continental
People Express, Inc.
Defendant in class-action securities-fraud suits
Rocky Mountain Aviation, Inc.
Acquired May 1986
Frontier Holdings, Inc.
Acquired Oct. 1986 from People Express
PRO Inc.
Ground support assets formerly owned by Eastern
Bar Harbor Airways, Inc.
Financing provided by Eastern
Britt Airways, Inc.
Feeds passengers to Continental
People Express Airlines, Inc.
Pays service fees to Continental
Rocky Mountain Airlines, Inc.
Feeds passengers to Continental's Denver hub
Frontier Airlines, Inc.
In chapter 11 since August 1986
Provincetowne-Boston Airlines Inc.
Acquired from People Express for $1

Reprinted from: Wall Street Journal, April 7,1988

Senator **Metzenbaum**. We have with us today the ranking member of the subcommittee. I'm very happy to hear from you, Senator Thurmond, happy that you're here with us.

OPENING STATEMENT OF SENATOR THURMOND

Senator **Thurmond**. Thank you, Mr. Chairman. I have a little laryngitis. I won't be able to talk very loud.

We are here today to consider S. 544, a bill introduced on March 8th, 1989, which would amend various provisions of the Bankruptcy Code with respect to chapter 11 petitions filed by air carriers. With the recent dispute between Eastern Airlines and its employees, and the subsequent bankruptcy filing by the corporation, there's appropriate concern as to whether Eastern can survive as a major air carrier in the United States.

Regarding this legislation, if enacted, S. 544 would place limits on the modification of labor-management agreements entered into between air carriers and their employees as part of a chapter 11 reorganization plan.

In addition, the bill would require that, in most instances, each subsidiary company cannot file a bankruptcy petition without the simultaneous filing of its parent corporation, thereby making the assets of its parent corporation available to the creditors of the subsidiary.

S. 544, if enacted in its current form, would be retroactive back to the day it was introduced, March 8th, 1989.

In closing, when the Federal Bankruptcy Code is amended, and it must be done so only after comprehensive study, because any modification may substantially affect the rights and liabilities of all parties to a bankruptcy proceeding.

This legislation focuses on the rights and liabilities between the employees and the corporate management in one specific industry, the airline industry. Therefore it should receive this committee's most careful attention and cautious consideration.

I look forward to hearing from our distinguished panelists as to the possible ramifications of this legislation.

Senator **Metzenbaum**. Thank you very much, Senator Thurmond.

I might say that the chair had indicated this meeting was of the subcommittee. In fact this is a meeting of the full committee, and the Senator at my left is ranking member of that committee.

Senator Simon, happy to have you with us here this morning.

OPENING STATEMENT OF SENATOR SIMON

Senator **Simon**. Thank you very much, Mr. Chairman.

I regret that the Budget Committee is just starting to work on the budget so I am not going to be able to stay. But I want to, first of all, commend you for introducing the legislation. I am pleased to be a cosponsor of the legislation.

Clearly we have to deal with this kind of nonsense that is displayed here on this chart. Now, if this issue were simply an issue regarding the interrelationship of various corporations, that's one thing. But there has been a new word added to the lexicon of America financing, thanks to Mr. Lorenzo, and that's upstreaming.

Upstreaming is siphoning off the assets of one corporation onto another and letting one of those corporations die. If published reports are accurate, you have a situation where Eastern acquired a small commuter airline for $1.5 million, and paid a $1 million financial advisory fee to one of the parent corporations for advising on that $1.5 million acquisition.

In another situation, Eastern had a computer reservation system that, according to Eastern's own books, was worth somewhere between $200 and $300 million. The computer reservation system was sold for 100 million in paper, that's probably only worth $28 to $30 million, and signed a contract. This means that Eastern pays the parent corporation $130 million a year for the use of the computer reservation system.

Clearly we have an abuse here, and we are considering emergency legislation on the floor of the Senate. I just spoke on the floor of the Senate on this matter, and someone said to me on the way over here that it looks like Frank Lorenzo is very anti-union. I don't think that's it. I just think he's out for every buck he can get, no matter where it comes from, no matter how he gets it. And, we have to stop this kind of thing.

If the courts can determine where the proper lines are, corporations won't be able to upstream assets and then not have any kind of liability whatsoever. And, with this kind of legislation you can't hide assets. This is a measure that is a good sound measure. It may need some modification, but I commend you, Mr. Chairman, for moving on it. I hope we move on this bill quickly.

Senator METZENBAUM. Thank you very much, Senator Simon.

Our first panel today consists of Mr. William Winpisinger, President of the International Association of Machinists, accompanied by Joseph Guerrieri of Guerrieri, Edmond, and James; and Captain Henry A. Duffy, President of the Air Line Pilots Association, accompanied by Bruce Simon of Cohen, Weiss, and Simon.

We are happy to have both of you with us.

Before proceeding with the panel, we have several statements of members of this committee, which will be included in the record.

[The statements of Senators Kennedy, Hatch, DeConcini, and Grassley follow:]

STATEMENT OF SENATOR EDWARD M. KENNEDY
HEARING OF THE SENATE JUDICIARY COMMITTEE ON S. 544
AIRLINE BANKRUPTCY LEGISLATION
MARCH 17, 1989

I want to commend Senator Metzenbaum for chairing this hearing and for bringing before the Senate the issues raised by the bankruptcy filing of Eastern Airlines.

Our bankruptcy laws were intended to give businesses in distress the chance to seek court protection while they reorganize their affairs. Reorganization can save productive businesses and preserve jobs.

But our bankruptcy laws should not provide a road map by which union-busting management can strip a business of its valuable assets and leave behind a debt-ridden shell unable to carry on its business.

That is exactly what Texas Air has done with its subsidiary, Eastern Airlines. Over the past three years, Texas Air has systematically looted Eastern of its most valuable assets in a long series of highly questionable transactions. To name just a few examples:

o In April 1987, Eastern sold its pretigious computer reservation system to Texas Air for a give-away price of $100 million, payable over 25 years at a give-away interest rate of 6%. Eastern now pays Texas Air $10 million dollars a month to rent the system. So Texas Air makes more each year from the system than it will have to pay Eastern twenty-five years after the purchase.

o Eastern sold 11 gates at Newark Airport to Continental for a ten million-dollar ten percent note due in 1998, about half their appraised value.

o Eastern also pays Texas Air $12 million a year in fuel service fees and $6 million a year in management fees, all without any apparent benefit to Eastern.

o Eastern also tried to sell its Shuttle to Texas Air for $125 million in cash and a $100 million note, far below the price recently agreed to by Donald Trump.

These dubious deals, and a host of other questionable loans, fees, payments and other transactions between Eastern and Texas Air, have enriched Texas Air and its non-union subsidiary, Continental, while driving Eastern into bankruptcy. Texas Air should not now be able to use that bankruptcy proceeding to protect it from claims that it has short-changed Eastern with this elaborate corporate shell game.

We will hear testimony today from distinguished witnesses on whether the current bankruptcy laws are adequate to prevent abuses of this kind. I am convinced that wrongs have occurred, and I certainly want to see them corrected -- by the bankruptcy court, if possible, or by Congress, if necessary.

I look forward to hearing fomm our witnesses.

Opening Statement S. 544

Hatch
3-17-89

I wish to express my serious concerns regarding S. 544, a bill which seeks to amend sections of the bankruptcy code in very significant respects. These include, first, the impact that the proposed changes would have on the pending bankruptcy proceeding involving Eastern Airlines. My general view is, of course, that the current dispute between Eastern and its unions is a private matter that ought to be resolved without Congressional intervention. Second, I believe that this bill raises serious complex legal questions which need to be considered. Finally, and most importantly, I am extremely concerned about the effect that S. 544 would have on the airline industry as a whole, on the national economy, and on the public.

Thus, because of the far-reaching consequences of these amendments, I urge that this committee proceed cautiously in its analysis and deliberation. And, in this regard, I also urge that the record of this hearing be left open for a considerable period of time. Because of the haste in which this hearing is upon us, I believe it is imperative that we have an opportunity to obtain as much input as possible from additional experts and interested parties. I appreciate the witnesses coming today on such short notice. I look forward to reviewing their testimony as well as additional statements which may be forthcoming.

STATEMENT OF SENATOR DECONCINI AT THE JUDICIARY COMMITTEE HEARING ON S. 544
A BILL TO AMEND THE BANKRUPTCY CODE
MARCH 17, 1989

Mr. Chairman, I commend you for conducting this hearing in such an expedient manner. The problems associated with the recent developments at Eastern Airlines call for our immediate attention, and it is very insightful of you to have scheduled this hearing to address those problems on such short notice.

I have been very active in the Bankruptcy field. As a sponsor of numerous pieces of bankruptcy legislation enacted into law, some of which are affected by the proposal being considered today, I have a special interest in seeing that the long term objectives of the Bankruptcy Code are not undermined because of a desire to respond to an immediate problem, such as the Eastern Airlines dispute.

S. 544, a bill intended to modify the collective bargaining agreements subject to the Railway Labor Act and expand the pool of assets to be considered for Chapter 11 bankruptcies, in addition to other changes, raises many questions which I hope to be answered at today's hearing, or subsequent hearings on this issue.

Mr. Chairman, I am sorry to say that I am unable to attend today's hearing due to prior commitments. While the benefits of holding today's hearing in such a timely fashion are clear -- the issue is the focus of nearly all those interested in bankruptcy -- it also results in this Senator being unable to be in two places at one time. This I regret. However, I am confident that all views will be discussed, and that fairness will prevail.

Mr. Chairman, I have read much of the written testimony submitted by the distinguished witnesses called to testify today. In addition, I am submitting questions that I would ask the witnesses to respond to, and that both the questions and answers be made part of the record.

Thank you Mr. Chairman.

Statement of Senator Charles E. Grassley
Hearing on S. 544
Committee on the Judiciary
March 17, 1989

Laws relating to bankruptcy and insolvency have existed for thousands of years. In this country, the first bankruptcy laws were enacted in 1800, with the first permanent law enacted in 1898.

The adoption of a uniform federal bankruptcy law provides certainty to individual and commercial business relationships, and has greatly enhanced our economic development. It serves both public and private goals, by removing oppressive debts from honest debtors in need of a fresh start. Changes to the Code have been rare; indeed, the law was largely unchanged between 1898 and 1978. Proposed amendments to the Code have always been carefully scrutinized. Changes to the Code are not made retroactively, for both constitutional and fairness reasons.

Reorganization, rather than liquidation, is the hallmark feature of American bankruptcy law. Chapter 11 of the Code provides a financially troubled business with an opportunity to restructure its affairs to enable the continuation of business. Chapter 11 permits a debtor to remain in control of its assets and operations while negotiating a restructuring. Both the debtor and its creditors benefit from this orderly process. The public also benefits when the debtor remains a viable entity, through the preservation of jobs and continued production of goods and services. As the Supreme Court put it in NLRB v. Bildisco:

> The fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources.

Congress has determined that in our credit-oriented society it is essential that there be appropriate escape valves to enable an overextended debtor to reorganize a business. At the same time, Congress has carefully balanced the rights of creditors to equal and fair treatment. This balance ought not to be disturbed without compelling need and careful study.

Historically, airlines and railroads have been treated differently under the Code. The unique treatment afforded railroads is based upon the absence of competition on particular rail lines. In reality, when a railroad ends service of a particular route due to a bankruptcy, no other operator can immediately fill the void. This seriously disrupts, if not precludes, passenger and freight users from access to rail transportation. The same concern over disruption does not exist in air transportation, where numerous carriers and alternative routes can fill any void caused by one airline's bankruptcy.

Section one of this bill would ignore this longstanding rail-air distinction, and end the unique treatment given to railroad reorganizations, without a compelling reason.

Moreover,in 1984, Congress squarely dealt with the issue of assumption and rejection of collective bargaining agreements in Chapter 11 cases. In my judgment, an unfettered collective bargaining process is essential to cooperative and effective relations between labor and management. The way in which collective bargaining agreements are treated in bankruptcy is therefore critical.

The 1984 amendments, which were the product of long discussions and careful analysis, require good faith negotiations, within strict time frames, to attempt to save both the labor contract and the business. The amendments met the interests of labor by prohibiting unilateral rejection of labor agreements without court review of whether rejection is necessary to save the business. The amendments also accommodated the interests of business and labor by providing debtors with the flexibility they need to reorganize successfully and preserve jobs for workers. Finally, the amendments recognized the bedrock principal of American labor law that the parties -- not courts or legislatures -- are best equipped to determine the terms and conditions of employment.

In short, the amendments provided a workable framework for making the difficult questions involved in reorganization both fair and equitable. There is no evidence that this framework is now unworkable, or in need of repair. Yet section one of this bill, by preventing the alteration of a debtor-air-carrier collective bargaining contract, would suddenly alter this careful balance. Because I believe it is better for parties to labor-management disputes to bargain in good faith, rather than to seek resolution by legislation, I cannot support this approach.

The bill also proposes to amend the Code by requiring that all affiliated companies under common control be included in the bankruptcy of a particular company. While I do not pretend to know the intricacies of corporate law, I do know that this would effectively "pierce the corporate veil" of every bankruptcy filing, whenever there are affiliated companies. This seems to me unfair. First, courts already have well-established guidelines regarding the circumstances appropriate to finding that what appear to be separate companies are really a single entity. Second, consolidation of corporate entities would deprive creditors of important rights without a hearing. For example, a solvent company's assets could be diverted to the failing company without the former's creditors having a right to be heard.

Mr. Chairman, given the significance of the proposed changes, and the short time in which members have had to study the bill, I believe it important that the hearing record be kept open for a significant period of time -- perhaps 30 days -- so that others may have an opportunity to be heard.

Senator METZENBAUM. Mr. Winpisinger, Captain Duffy, we are happy to see you here this morning. We have a 5-minute rule normally. We will extend that somewhat provided you don't try to filibuster. [Laughter.]

That's our prerogative.

Mr. Winpisinger, will you please proceed?

STATEMENT OF A PANEL CONSISTING OF WILLIAM W. WINPISINGER, PRESIDENT, INTERNATIONAL ASSOCIATION OF MACHINISTS, WASHINGTON, DC; ACCOMPANIED BY JOSEPH GUERRIERI, GUERRIERI, EDMOND & JAMES, WASHINGTON, DC; CAPTAIN HENRY A. DUFFY, PRESIDENT, AIR LINE PILOTS ASSOCIATION, WASHINGTON, DC; ACCOMPANIED BY BRUCE H. SIMON, COHEN, WEISS & SIMON, NEW YORK, NY

Mr. WINPISINGER. Well, thank you very much, Mr. Chairman, for the opportunity to be here this morning, and I shall do my best to summarize within the normal time constraints. I am not much of a filibusterer.

You have already indicated who I am. And I would point out that we represent something in excess of 800,000 members all across the industrial and service complex of our country. And we happen, coincidently, to be the largest union in the air transport industry representing some 95,000 mechanics and related employees. And I appear today in support of S. 544.

In the 10-year period since deregulation became effective, enormous damage has been done to our members and workers all over this industry, and on the traveling public as well because of the use by some of the carriers of bankruptcy as something of a sword and shield. And the wreckage from that shows that in the first 2 years of deregulation, some 50,000 of our members lost their jobs—excuse me, 50,000 people in the industry lost their jobs, and some 35,000 of ours were seriously discommoded and had their lives disrupted by mergers, acquisitions, route transfers, and bankruptcies.

And these people have been particularly victimized by the operation of the bankruptcy statutes as they have existed. Braniff was the lead case. And while the airline management may have been protected in that case, the 2,000 people we represented disappeared and only 200 were ultimately called back to their jobs.

Air New England was another casualty when it was forced to liquidate, and all of its IAM represented employees disappeared. And I need not remind the committee, even the notoriety of it, that bankruptcy has become a tool in the hands of people like Mr. Frank Lorenzo to break their unions. He shut down Continental for 3 days in 1983 with $50 million in the cash drawer, and boasted about it, and openly said that the purpose of that 3-day shutdown was to enter chapter 11 protection and vitiate the labor agreements that were then in force on that property. And he got away with it. And it has taught something of a lesson to many others who attempt from time to time to emulate it. Currently he is trying to keep his batting average at 1,000 because of two carriers, two bankruptcies in the space of 5 years.

And I would point out that the Railway Labor Act has governed labor relations in the transportation industries, rail and air, in this country for well over 50 years now, and I think have served the Nation admirably well.

And we believe that Congress originally intended that coverage under that Act would control labor relations. And through an unfortunate wording of prior statutes, railroads were explicitly covered, and airlines were omitted in terms of specificity. And we have this duplicity now where rail agreements can only be altered in bankruptcy under the procedures of the Railway Labor Act. And we believe it is right and proper therefore in this instance that airlines be extended that same coverage in order to bring to a screeching halt, using bankruptcy as a union busting tactic.

That was all encompassing as far as the *Continental* case was concerned. Congress did amend the statute thereafter, but there are still the loopholes which this bill seeks to redress. And section 1113 specifically focuses on the abuse of contract rejections in bankruptcy, and we think it was intended to govern the status of collective bargaining relationships in the chapter 11 reorganization proceedings, and it requires a debtor to negotiate over proposed changes to a labor contract and make an equitable showing to the Bankruptcy Court before it can reject those agreements. And we think that is a perfectly logical and appropriate course.

Now, section 1167 provides that the trustee in a railroad reorganization may not alter employee wages and conditions. We think that logically should reach to the other coverage under the Act, meaning airlines.

We fully support as well the second aspect of the coverage of S. 544, and that is the proposed amendment to section 109. And that amendment reaches to the very elaborate presentation you have here, and would require members and their carrier's control group of corporation, including parent-holding companies and related subsidiaries, to enter bankruptcy if the air carrier property does so. And the purpose would be, of course, to centralize control over the debtor's chapter 11 administration and prevent these parent-holding companies or other related entities from escaping the reach of the creditors. And these control groups are recognized, as we believe they should be, for pension liability purposes already, and clearly the purposes of bankruptcy, nominally meaning the reorganization of a troubled entity and the fair treatment of creditors would be furthered by that amendment.

Since the deregulation of the air transport industry, many of these corporations have shown a remarkable propensity for erecting these kinds, as depicted by that chart, of crazy quilt corporate organizations which have the ability and the result of financial insulation, and the coziness of all of these interlocking Boards of Directors and integrated services between the various siblings. And they thereby enjoy the synergism of all of these fully coordinated activities and, yet, because of the present state of the law, these same airlines when they are confronted with the bankruptcy of one of the subsidiaries can suddenly deny that any relationship exists between them and the parent. And the bankrupt company then becomes treated as something of an orphan, and the assets of all of its former relatives are fully shielded and protected.

And we think simple justice demands that these holding companies not be allowed to abandon the sick offspring and to ignore the claims of the legitimate creditors, including their employees.

And Texas Air, we think, provides the most dramatic example thus far. It is here before one and all and shows very accurately exactly what goes on.

Literally from the first day of the acquisition of the Eastern Airline property by the Texas Air Corporation, there has been an upstreaming effect ongoing as Eastern's assets were bled off and transferred to either Texas Air and/or Continental, or through one to the other, the effect of which is to buttress the operation of Continental, diminish the operations of Eastern, and it is not entirely coincidental that Continental is a nonunion airline and, therefore, serves the interest of Texas Air Corporation to destroy the unionized mind in favor of that which is not, and it's interesting to note, we think, that in spite of that, and in spite of Continental Airlines enjoying the lowest labor costs in the industry by a very, very substantial margin, they continue to lose more money, and have lost more money over the past 2 years than has been lost by Eastern Airlines, even with this upstreaming drastically affecting Eastern.

I think that states the case quite adequately, Mr. Chairman, and I relinquish whatever time there may be remaining.

[The statement of Mr. Winpisinger follows:]

Statement of William W. Winpisinger
On Behalf of the International Association
of Machinists and Aerospace Workers
Before the Committee on the Judiciary
U.S. Senate

March 17, 1989

Mr. Chairman and Members of the Committee:

My name is William W. Winpisinger, and I am the International President of the International Association of Machinists and Aerospace Workers ("IAM"). The IAM represents 801,451 employees in a variety of industries throughout this nation. We are the largest union in the air transport industry representing 95,000 mechanics and related employees. I testify today in support of Senate Bill 544.

During more than ten years of deregulation of the airline industry, incalculable damage has been inflicted on workers, the traveling public, and the creditors of those carriers that have used bankruptcy as a sword and a shield. The battlefield of this deregulated industry is strewn with both corporate and human casualties. In the first two years of deregulation, 50,000 workers lost their jobs. Some 35,000 IAM members had their lives and jobs disrupted by mergers, acquisitions, route transfers, and bankruptcies. Thousands of retirees have struggled to survive the loss and suspension of their pensions due to the bankruptcy of their employers and the cessation of operations of a number of carriers.

Air transport employees have been particularly victimized by carriers who have used and abused our bankruptcy laws. As a result of deregulation in May of 1982, Braniff Airlines filed for protection under Chapter 11. While the Braniff Airlines management may have been protected of the 2,000 people we represented on that carrier only 200 were recalled by 1983. Air New England became a casualty of deregulation when it was forced to liquidate and all of its IAM-member employees lost their jobs.

Moreover, the bankruptcy laws were also utilized to break unions. I needn't remind this committee that Frank Lorenzo took Continental Airlines into bankruptcy pursuant to Chapter 11 on September 24, 1983. He shut the airline down for three days, abrogated union contracts, and froze the IAM pension plan. Of the 11,000 employees of Continental, only 4,000 were returned to employment and many at half their previous wages. This abuse of our bankruptcy laws and victimization of thousands of employees was done while Continental still had $50 million in cash and $200 million in unencumbered equipment.

Until the advent of deregulation, labor management relations in the air transport industry where quite stable. The Railway

Labor Act which governs labor relations in the railroad and airline industries served this nation well in bringing about the peaceful resolution of labor management disputes. However, in 1983 bankruptcy began to be used as a means of short circuiting the procedures of the Act. Bankruptcy became an instrument of torture to be used by unscrupulous management against its employees. Through Mr. Lorenzo's example at Continental Airlines, carriers discovered that if they were dissatisfied with their union contracts they need only apply for "bankruptcy" under Chapter 11 of the Bankruptcy Code and reject their obligations to their unionized employees. Thus with the stroke of a pen they were rid of obligations that were fought for and won through collective bargaining.

Under the Railway Labor Act, a union must "make and maintain agreements with those air carriers whose employees the union has been certified to represent." These agreements must be negotiated in good faith and once executed the employees, the unions and their employers -- for good or ill -- are stuck with them. No union and no individual or group of employees, nor management, can vary the terms or disavow the terms of such agreements without exhausting the procedures of the Act.

We believe that Congress fully expected a debtor-in-possession to observe specific statutory requirements whether they be laws regulating occupational safety and health or laws governing labor relations. Chapter 11 is not and should not be a license for lawlessness. The labor relations statutes of this country are "public law," obligations not one wit less significant than the other public legal obligations binding us all, including debtors in possession.

The Continental Airline bankruptcy in 1983 raised a fundamental question which was resolved only in part by subsequent amendments to the bankruptcy law: "May an employer seek recourse to the bankruptcy court purely and simply for the purpose of voiding its labor contract?" Continental Airlines was a solvent, cash-rich company boasting $50 million in the bank on the very first day it filed for Chapter 11. The Chairman of the Board, Frank Lorenzo, made no pretense of his motives in filing for Chapter 11: to rid himself of union contracts and to slash his labor costs. Chapter 11 was used as a collective bargaining weapon, not as a shield for the protection of a distressed business that needs a period of protection from its creditors while it "rehabilitates" itself. Thus, he acted in total disregard of the obligation to make and maintain agreements under the Railway Labor Act. In our view, the basic requirement that bankruptcy relief must be sought "in good faith" should ultimately result in the dismissal of Chapter 11 petitions filed by solvent businesses for the purpose of voiding labor contracts. In any event, no carrier should be absolved of its statutory duty to exhaust those procedures imposed by the Railway Labor Act.

The proposed amendments to Section 1167 are necessary to close a remaining loophole in the law. This bill simply provides the same protection for employees of a Chapter 11 airline debtor as are currently provided for railroad employees. In the Bankruptcy Amendments and Federal Judgeship Act of 1984 Congress adopted a wholly new provision of the bankruptcy code, Section 1113 which was directed at the abuse of contract rejection. That section was intended to govern the status of collective bargaining agreements in Chapter 11 reorganization proceedings. Section 1113 requires a debtor to negotiate over proposed changes to a labor contract and make an equitable showing to the bankruptcy court before it can reject that collective bargaining agreement. However, in recognition of the differences between the Railway Labor Act and the National Labor Relations Act, Congress excluded railroads from the application of Section 1113. Thus, railroads who have filed for reorganization under Chapter 11 are still bound to negotiate changes in collective bargaining agreements pursuant to the Railway Labor Act. Section 1167 provides that the trustee in a railroad reorganization may not alter employees wages or working conditions except in accordance with Section 6 of the Railway Labor Act. Section 6 forms the bedrock of labor relations in the transportation industry. It imposes upon the parties a mandatory framework for reaching an agreement and avoiding disruptions to commerce. The procedures of the Railway Labor Act apply with equal force to both airlines and railroads. It is simply nonsensical to create an artificial distinction between airlines and railroads for the purpose of changing or rejecting valid collective bargaining agreements in bankruptcy. Regardless of whether the carrier transports cargo and people by rail or by air, the same statutory scheme governing labor relations should abide even throughout a bankruptcy proceeding.

Negotiations with labor, conducted in good faith under the Railway Labor Act, can be productive for an ailing business seeking to avoid collapse. And even if bankruptcy is inevitable, labor participation can help effectuate a sound reorganization plan. We must keep in mind the effectiveness and wisdom of this system so as to preserve it from total destruction at the hands of the bankruptcy process. We must not allow the current irresponsible and cynical use of bankruptcy to destroy the viability of this time-tested system.

We also fully support the second aspect of the proposed amendment to Section 109, 11 U.S.C. § 109. This amendment would require the members of an air carriers' control group of corporations, including parent holding companies and related subsidiaries, to enter bankruptcy if the air carrier does so. The million bearing an interest rate of only 6 percent and due in 2012. Eastern was then made to rent what was once its own computer system for $10 million per month. In one year alone Eastern has paid more for this system than the total amount of money it received from Texas Air. Eastern has also been required to pay $500,000 per month in a management fee to Texas Air for the privilege of being mismanaged into bankruptcy.

Lorenzo has used Eastern to pump over $180 million into Continental. This includes $120 million in direct loans and financing, and $60 million for strike services and a joint frequent flyer plan. Eastern supplied $27.1 million in net payments to finance Continental's acquisition of a 50% interest in Bar Harbour Air Lines. Eastern has begun the process of transferring its valuable Latin American routes to non-union Continental. Eastern has also sold 11 gates at the airport in Newark, New Jersey to Continental. During 1987 Eastern sold or leased 19 of its aircraft, reducing its fleet by nearly 6 percent to 279 aircraft. While Eastern's fleet was shrinking, Continental's continued to grow from 206 in December 1986 to 347 planes in November 1987. These infusions of both cash and equipment into Continental all came at a time when Eastern claimed it needed hundreds of millions of dollars in concessions from its workforce to remain viable. In fact, even this morally bankrupt scheme of robbing Peter to pay Paul has not produced the intended result. Continental, despite the lowest labor costs of any major carrier lost money at a faster rate than Eastern. This nonunion carrier lost over $50 million more than Eastern in the past two years.

Bankruptcy will permit Eastern to be relieved of making payment on $2.3 billion of long-term debt as well as leases on airplanes, terminals and the like. Creditors such as bondholders and banks are due $1.6 billion in loans secured by a particular asset such as planes and spare parts. There are unsecured creditors such as suppliers and ticketholders as well as other airlines that have honored their tickets who may be owed as much as $250 million. There are preferred stockholders who stand to lose more than $1 billion. However, Eastern's unionized employees will be the hardest hit. They are owed millions of dollars in back pay, $200 million in preferred stock and as much as $750 million in future pension payments. All this after Eastern's employees gave a billion and a half dollars in concessions to their employer over the past ten years.

In the process, Texas Air has accelerated its exploitation of Eastern Airlines for non-union Continental's benefit. Continental has already begun flying Eastern routes. As Professor Harley Shaiken, labor professor at the University of California at San Diego, stated recently in The Wall Street Journal, Continental's latest move "underscores what Texas Air has done all along, shift business from Eastern. The strike only makes it easier." Lorenzo's Eastern management has downsized Eastern by more than 25% before the strike and now say they plan to shrink this once-proud airline by an additional 50%, while in bankrutpcy. Thus, unionized Eastern will be shrunk into oblivion while its creditors are foreclosed from having their legitimate claims satisfied. Texas Air and its non-union subsidiary will expand, bloated by the former assets and monies of its sister carrier. This legislation will pierce the corporate veils that now enshroud companies like Texas Air and thereby enable creditors to be paid what they are owed.

Because of the looting of Eastern Airlines its assets will prove insufficient to pay off Eastern's lenders, ticketholders, employees and unpaid suppliers. There is no question that in such cases the balance of the control group must be brought into the bankruptcy in such cases for the protection of creditors. Indeed Lorenzo himself admitted last week that Texas Air is "substantially capitalized" with in excess of $300 million in cash. Chapter 11 is a portion of the Federal bankruptcy law that gives a corporation protection from its creditors while it attempts to reorganize its debts. It assumes that the company or new owner intends to go on operating the business. That assumption is not applicable where the parent company has dismantled one of its subsidiaries to the benefit of the parent.

Under the present laws, though Texas Air has engorged itself with the assets of Eastern while starving this subsidiary into bankruptcy, it can nonetheless avoid all financial responsibilies for its action. We at the IAM, therefore, urge passage of Senate Bill 544 to correct the loopholes in the revised 1984 bankruptcy law to require carriers that "upstream" their assets to parent corporations also "upstream" their liability for the protection of creditors.

Senator METZENBAUM. I have some questions, but I think first I would like to hear from Captain Duffy of the Air Line Pilots Association.

STATEMENT OF CAPTAIN HENRY A. DUFFY

Captain DUFFY. Thank you, Mr. Chairman. On behalf of the 41,000 ALPA represents at 47 airlines in this country, we appreciate this opportunity to testify in support of the amendments to the Bankruptcy Code as provided in S. 544.

ALPA strongly supports this bill and commends you for its introduction. Let me summarize our arguments.

First, section 1167 of the Bankruptcy Code should be amended to make clear that the wages and working conditions of employees in the airline industry, like those of rail employees, may not be altered during a chapter 11 reorganization. The only exceptions allowed would be in accordance with the dispute resolution procedures found in section 6 of the Railway Labor Act. This issue is a simple case of unintentional oversight that now urgently needs clarification by the Congress.

The Railway Labor Act's purpose is to promote labor peace and avoid disruption of this Nation's vital transportation services. It was only natural that the Act was amended to include the air industry as it grew to become a critical link in our transportation system.

Without getting into the history of section 1167 of the Bankruptcy Code, it should be sufficient to note that section 1167 explicitly applies to all collective bargaining agreements subject to the Railway Labor Act. Unfortunately, section 1167 was placed in a section of the Bankruptcy Code that applies to railroad reorganizations. This has led to confusion and misinterpretation.

Since there is absolutely no rational policy basis for including rail but not air carriers under section 1167, the Bankruptcy Code should be amended as proposed in S. 544. This action should be viewed by Congress as a technical correction as it involves no actual policy change. Lack of action on this provision means continued use of the Bankruptcy Code as a loophole through which the purposes of the Railway Labor Act, labor stability and the uninterrupted operation of our national transportation systems, will be undermined.

Second, 109(d) of the Bankruptcy Code should be amended to provide that an air carrier may only become a chapter 11 debtor if every member of the carrier's "controlled group of corporations" simultaneously files for bankruptcy. It should also provide for automatic substantive consolidation of all chapter 11 reorganizations involving an air carrier and its controlled group.

Certainly the authors of the Bankruptcy Code could never have envisioned the maze of corporate structures, mergers and acquisitions that have come to define the airline industry today, nor could they have envisioned the abuse of legal and financial options that have occurred.

For example, the Pan Am Corporation is the parent corporation and sole owner of three subsidiary air carriers—Pan American World Airways, Pan Am Express, and Pan Am Shuttle, Inc. Similarly, the U.S. Air Group controls seven subsidiary airlines. And, of course, we have the example nearest and dearest to our hearts, Texas Air Corporation, the sole owner of Continental Airlines and Eastern Airlines. In fact, Texas Air itself is controlled by another corporation, Jet Capital.

Thus, we are now presented with a situation in which a parent corporation causes a subsidiary's bankruptcy by shifting valuable assets from the subsidiary to another. Yet, there is no guarantee the parent corporation will have to face the consequences of its actions in Bankruptcy Court. In a sense, it's the same as protecting parents who abuse their children from ever going to court or to jail. This is dead wrong. And the Eastern situation provides us with perfect evidence why this provision must be amended.

Since Frank Lorenzo bought Eastern, he has systematically transferred that once great airline's assets to Texas Air and non-union affiliates.

I've included in my written testimony the evidence of this asset stripping scheme. This includes questionable financial transactions, the near give-away of Eastern's reservation system to Texas Air, and the transfer of valuable planes and routes.

This predatory activity poses substantial safety concerns. An air carrier must have sufficient resources to provide first-rate maintenance and needed new equipment purchases. Yet, an airline that is undercapitalized can pose a long-term risk to the flying public because of its inability to afford the costly inspections and repairs needed to maintain an aging fleet.

Second, this predatory activity undermines labor relations. Labor has demonstrated a willingness in the past to make sacrifices for corporations undergoing legitimate financial difficulty. But when the company's crisis is due to asset stripping by the parent corporation, that has made its union busting intentions quite clear, it's understandable why labor is reluctant to provide costly concessions. The resulting deterioration of labor relations can, as it did at Eastern, lead to strikes and disruptions. This clearly frustrates the expressed statutory purposes of the Railway Labor Act.

And, finally, this predatory activity improperly jeopardizes the investments of the creditors of undercapitalized subsidiaries, including those citizens, as you pointed out, who bought advance plane tickets.

The amendments proposed in S. 544 addresses each of these three concerns. S. 544 will encourage all members of parent corporations to practice fiscal responsibility. It will deter subsidiary abuse. Moreover, in the event of an airline's bankruptcy, this legislation will protect both secured and unsecured creditors as long as the other members of the control group are viable as in the case of Texas Air Corporation.

As a result, airline investor competence will increase. This in turn will aid airlines in funding maintenance costs and acquisition of new aircraft to replace aging fleets.

And, finally, these amendments will help to ensure labor tranquility and maintain the uninterrupted movement of goods and people in the airline industry.

Thank you, Mr. Chairman.

[The statement of Captain Duffy and response to questions follow:]

STATEMENT OF

HENRY A. DUFFY, PRESIDENT

AIR LINE PILOTS ASSOCIATION,

INTERNATIONAL

BEFORE THE

COMMITTEE ON THE JUDICIARY

U.S. SENATE

March 17, 1989

S. 544

AMENDMENTS TO THE BANKRUPTCY CODE

Good morning. I am Captain Henry A. Duffy, President of the Air Line Pilots Association, International. ALPA is the collective bargaining agent under the Railway Labor Act for the pilots of 47 commercial air carriers in the United States, including nearly all of the major carriers such as Eastern, Northwest, United, Trans World Airlines, Pan American Airways and Delta.

The President of ALPA, as are all its other national officers, is elected by the Board of Directors, ALPA's highest governing body. I was first elected President in November, 1982, and in November, 1986 was reelected to serve a second four-year term.

I strongly recommend that Congress enact the amendments to the Bankruptcy Code as provided in S. 544.

First, Section 1167 of the Bankruptcy Code should be amended to make clear that the wages and working conditions of employees in the airline industry, like those of employees in the rail industry, may not be altered during a Chapter 11 reorganization except in accordance with the dispute resolution procedures found in Section 6 of the Railway Labor Act. Secondly, Section 109(d) of the Bankruptcy Code should be amended to provide that an air carrier may only become a Chapter 11 debtor if every member of the carrier's "controlled group of corporations" simultaneously becomes a Chapter 11 debtor, and to provide for automatic substantive consolidation in all Chapter 11 reorganizations involving an air carrier and its controlled group. I am also submitting written comments to the Committee addressing the legal basis for amending Section 1167 and demonstrating why the proposed legislation is constitutionally permissible.

The Railway Labor Act is the oldest continuous federal collective bargaining legislation in this nation's history. Its goal is to promote labor peace and avoid disruption of this nation's vital transportation services. To that end, the RLA contains a comprehensive structure for resolving labor disputes in the transportation industry. This structure embodies a delicate balance between labor and management interests.

At the heart of the RLA's dispute resolution processes is Section 6, the RLA's major dispute resolution provisions. Major disputes concern carrier or union attempts to change or repudiate provisions in existing collective bargaining agreements, as well as efforts to create or reach new collective bargaining agreements. Section 6's status quo provisions prohibit carriers and also unions from unilaterally altering rates of pay, rules, or working conditions during major disputes, pending the utilization and exhaustion of the Railway Labor Act's detailed and comprehensive collective bargaining processes. These processes include a 30 day advance written notice requirement, negotiations, mediation before the National Mediation Board and, if both parties agree, voluntary binding arbitration.

As originally enacted in 1926, the RLA only applied to labor disputes involving the rail industry. It became readily apparent, however, that anything that made for stability in labor relations and good morale in the railroad industry applied equally to the airline industry. Accordingly, in 1936, Congress amended the RLA to make it applicable to the then nascent, but growing air industry. Significantly, and with only one minor exception, the 1936 amendments made all the existing provisions of the RLA applicable to air carriers, including the Section 6 procedures to be followed whenever carriers wish to implement changes in existing collective bargaining agreements.

It is abundantly clear that, in amending the RLA, Congress intended to make air carriers and their employees integral parts of the legislative pattern of the Railway Labor Act, and to afford carriers and employees in the air industry the exact same benefits and obligations that were available and applicable to carriers and employees in the railroad industry. This was, of course, eminently reasonable since the very same public policy concerns that motivated Congress to enact the RLA - the avoidance of disruption of vital transportation services - motivated Congress to amend the RLA to include the air transportation industry. Significantly, these very same concerns led Congress to enact the current Section 1167 of the Bankruptcy Code.

Under Section 1167, collective bargaining agreements under the Railway Act are exempt from the Bankruptcy Code's general provisions governing rejection of executory contracts. In specific, Section 1167 provides that, notwithstanding the executory nature of collective bargaining agreements, the wages and working conditions of employees established by a collective bargaining agreement that is subject to the Railway Labor Act may not be changed during a Chapter 11 reorganization, except in accordance with the detailed processes for dispute resolution found in Section 6 of the Railway Labor Act. In making this exemption for RLA collective bargaining agreements, Congress recognized that the subject of railway labor is "too delicate" and "has too long a history" for the Bankruptcy Code to upset the established and proven procedures that have, under the RLA, been utilized to ensure labor peace and stability.

By its express terms, Section 1167 applies to all collective bargaining agreements subject to the Railway Labor Act. Moreover, Section 1167's language is significantly broader than that of its predecessor, Section 77(n), which spoke only of changes in the wages or working conditions of railroad employees. Notably absent from Section 77(n) was the expansive language of Section 1167 which refers to all collective bargaining agreements subject to the Railway Labor Act, and not just those involving railroad employees.

In fact, Section 77(n) was enacted in 1933, three years before the RLA was amended to include air carriers. Thomas Haggard and Mark Pulliam of the well-known Wharton Industrial Research Unit of the University of Pennsylvania, a research group that provides materials for national and international business communities, concluded that the expanded language of Section 1167 was meant to reflect the expanded coverage of airlines under the RLA. These two noted scholars found it difficult, in light of the inclusion of air carriers in the RLA in 1936 and the express language of Section 1167, to discern any basis for treating air carriers differently from railroads for bankruptcy purposes.

Nonetheless, Section 1167's placement in Subchapter IV of Title 11, a section of the Code that deals exclusively with railroad reorganizations, has created some confusion as to its applicability to the airline industry. As far back as 1965, however, when Section 77(n) was still in effect, the United States District Court for the Eastern District of New York concluded that a referee in bankruptcy was without power to reject a collective bargaining agreement, even under the narrow language of 77(n), because it was Congress' intention that the Railway Labor Act prescribe the exclusive means by which rejection of collective bargaining agreements may be effected. Recently, however, some courts, disturbed by the placement of the Section 1167 in Subchapter IV have ignored Section 1167's express language and held that Section 1167 applies only to cases concerning railroads.

The need to end this confusion and amend Section 1167 to specifically include the airline industry is manifest. The identity of purpose of the RLA, its 1936 amendments and Section 1167 of the Bankruptcy Code - the promotion of labor stability in the transportation industry - is patently clear. Since there is absolutely no rational policy basis for including rail but not air carriers under Section 1167, the Bankruptcy Code should be amended as proposed in S.544. Otherwise, the Code can be used to create a loophole through which the important statutory purposes of the RLA - labor stability and the vital public interest in the continued and uninterrupted operation of our national transportation systems - will be undermined.

Ample reasons also exist for supporting the proposed revision of Section 109(d) of the Bankruptcy Code as provided by S.544. Since the advent of deregulation, the airline industry has been marked by volatility and instability, as evidenced by the large number of mergers, acquistions, and most importantly for our purposes today, bankruptcies. Since 1979, 78 airlines have declared bankruptcy and an additional 115 airlines have ceased operations.

The potential for disruption is aggravated by the holding corporation-subsidiary structure which is the predominant mode of corporate organization in the airline industry. For example, the Pan Am Corporation is the parent corporation and sole owner of three subsidiary air carriers -- Pan American World Airways, Inc., Pan Am Express, Inc., and Pan Am Shuttle, Inc. Similarly, Texas Air Corporation is the sole owner of Continental Airlines and the embattled Eastern Air Lines, Inc. In turn, Texas Air is controlled by Jet Capital. Another example is the U.S. Air Group which controls seven subsidiary airlines within its corporate structure.

The prevalence of the parent-subsidiary structure in the airline industry raises public policy concerns inadequately addressed by the existing Bankruptcy Code. Thus, a parent organization which owns or controls one or more air carriers can shift assets among its controlled group of affiliated subsidiaries, maintaining overall operations while rendering one of its subsidiary air carriers substantially undercapitalized and vulnerable to bankruptcy. The Texas Air/Contintental/Eastern group is a prime example of this asset shifting. Since its acquisition of Eastern in 1986, Texas Air has engaged in a strategy to transfer Eastern's most valuable assets to Texas Air and other non-union affiliates. This strategy has been carried out under the guise of "improving Eastern's liquidity." In fact, the result of this strategy has been to provide Eastern routes to the non-union Continental and to diminish Eastern's value while enriching its affiliates.

Evidence of the asset stripping scheme of Eastern includes:

1. In November 1986, Eastern accepted a $16 million, non-interest bearing "due on demand" receivable in lieu of cash that Texas Air had agreed to pay Eastern as reimbursement for certain merger-related expenses. Eastern held this

non-interest bearing receivable almost two years without requiring Texas Air to pay the $16 million which it was legally entitled to receive on demand. Eastern made demand on Texas Air only after Courtroom questioning raised it as an issue.

2. In March, 1987, Eastern purchased from Texas Air a note issued by the nearly bankrupt People Express. The note due in 2001, had a face value of $30 million. Eastern paid Texas Air $25 million in cash for the note; Texas Air earned a $4.4 million profit on its sale of the note to Eastern. People Express' notes and certificates, as indicated in the February 1987 edicion of the Standard & Poor's Bond Guide, carry no rating.

3. In December 1987, Eastern paid a $22.5 million fee to Continental for nothing more than Continental's agreement to provide strike-related services.

4. On April 1, 1987, Eastern Air Lines entered into a Fuel Service Agreement with the newly created Texas Air Fuel Management, Inc. (TAC FMI). TAC

FMI is a wholly owned subsidiary of Texas Air. The agreement provided that Eastern purchase fuel-related services from TAC FMI with a surcharge of one cent per gallon which translates into approximately $10-12 million per year in fuel surcharge expenses, payable to Texas Air.

According to the DOT's Report on the Financial Fitness of Eastern:

> The claimed rationale for Texas Air fuel was to combine Eastern's and Continental's purchases to wrest concessions from fuel suppliers. Yet Eastern's demand by itself -- without supplementary Continental demand was sufficiently large that no increased buying power could be attributed by adding Continental. [DOT Fitness Report, Appendix 325, p.3.]

5. In March of 1987, Eastern sold Continental eleven Newark gates for $11 million, and accepted a 10 per cent promissory note due on December 31, 1998, in consideration. [EAL 10K, December 31, 1987, p. 48].

The DOT Report commented on the Newark gate transactions noting that:

> In March 1987, AVMARK (an airline consulting firm) appraised the Newark gates at $2.05 million each, and that AVMARK'S appraisal indicated that Eastern itself had placed a

> value of $1.875 million for each gate. [DOT Fitness Report, May 25, 1988, Appendix 330, p. 1 of 2].

6. Eastern sold 100 percent ownership of its Computer Reservation System, SystemOne, for a $100 million, subordinated, 25-year note bearing a 6 percent rate of interest with a convertible feature of dubious value, from Texas Air, a company with a "speculative" credit standing. SystemOne, when it was owned by Eastern, had a substantial and growing market share. Since Texas Air acquired SystemOne, its market share increased from 12 to 20 percent. Eastern recently estimated the current value of SystemOne at $750 million, an acknowledgement of the inherent underlying value of the asset. In contrast to the $100 million note that Eastern received, PARS, a comparable system, was sold using a $280 million total valuation in the approximate time frame as SystemOne was transferred to Texas Air. United sold 50% of the Apollo CRS System for $500 million, in May 1988, to 5 airlines. More recently, Delta combined its CRS' market share with that of the Sabre CRS System and purchased 50

> percent of the system for $650 million. Delta and American now plan to sell shares in the combined system for a total of $2 billion.

Such systemic stripping of assets ,may very well adversely impact on three crucial areas of public concern: public safety in the airline industry, labor relations and the status of creditors.

The transfer of assets poses substantial safety concerns. An air carrier, stripped of financial resources, manipulated by those whose interests are financial and not operational, flies at the peril of its passengers. An air carrier must have sufficient financial resources to fund maintenance and new equipment purchases -- and the corporate will to do so. An undercapitalized air carrier serving primarily as a financial pawn poses a long-term risk to the safety of the flying public, because of its inability to afford the costly repairs and inspections needed to maintain an aging fleet.

A significant portion of Eastern's fleet consists of aging Boeing 727s and DC-9s. It is common knowledge in the aviation industry that for every year an aircraft ages, it requires additional maintenance expenditures. This Committee must ponder the question of how a bankrupt air carrier stripped

of its most valuable assets and treated as a poor cousin in the Texas Air-Jet Capital family, can afford to shoulder an ever growing burden of maintenance costs and hope to continue to replace its first generation geriatric jet fleet.
Costly safety burdens, which the airlines have been faced with in recent years, simply cannot be satisfactorily met by a financially troubled air carrier, whose primary function is to serve the cash demands of its controlling interests.

Undercapitalization also undermines labor relations. A weakened financial condition caused by the upstreaming of assets can and has been used by the subsidiary air carrier to try to force labor into providing substantial economic and work rule concessions. Labor understandably hesitates to provide such costly concessions under such circumstances. The resulting deterioration of labor relations can, as it did at Eastern, result in strikes and disruption of the commercially important transportation industry, frustrating the express statutory purposes of the Railway Labor Act.

Finally, the same shifting of assets among affiliates of the controlled group improperly jeopardizes the investments of the creditors of undercapitalized subsidiaries.

The amendments proposed in S.544 address each of these concerns. S.544 will encourage all members of a controlled group to practice fiscal responsibility and would likely deter holding companies within the group from undertaking strategies which could negatively affect its air carrier subsidiaries. Moreover, in the event of an airline's bankruptcy, this amendment will protect both its secured and unsecured creditors, as long as the other members of the controlled group are viable. With such assurances, airline investor confidence will increase. This, in turn will aid airlines in funding maintenance costs and the acquisition of replacement aircraft for aging fleets. Finally, the amendments, by acting as a disincentive for the shifting of assets, will help to ensure labor tranquility and maintain the uninterrupted movement of goods and people in the airline industry.

ADDENDUM TO
TESTIMONY OF CAPTAIN HENRY A. DUFFY

1. Statement Supporting the Amendment of Section 1167 of the Bankruptcy Code by S.544.

The Bankruptcy Code should be amended to make clear that the wages and working conditions of employees in the airline industry, like those in the rail industry, may not be altered during a Chapter 11 reorganization without adhering to the detailed collective bargaining processes of Section 6 of the Railway Labor Act, 45 U.S.C. §156.

The Railway Labor Act, 45 U.S.C. §151 et seq. ("RLA"), the product of almost 40 years of Congressional experimentation, is the "oldest continuous Federal collective bargaining legislation in the Nation's history." C. Rehmus, The Railway Labor Act at Fifty, Collective Bargaining in the Railroad and Airline Industries, at pg. 8 (NMB 1976)("Rehmus"). To accomplish its goal - the promotion of labor peace and the avoidance of any interruption in transportation services - the RLA contains a comprehensive structure for resolving labor disputes in the transportation industry. See 45 U.S.C. §§152, First, 156.

This structure embodies a delicate balance between labor and management interests. At the heart of the RLA is Section 6, 45 U.S.C. §156, its "major dispute" resolution provisions. Major disputes concern carrier (or union) attempts to change or repudiate provisions in existing collective bargaining agreements as well as efforts to create or reach new agreements. In such circumstances, Section 6's status quo provisions prohibit carriers (and unions) from unilaterally altering "rates of pay, rules, or working conditions" pending the utilization and exhaustion of the RLA's detailed and comprehensive collective bargaining processes, including a 30 day advance written notice requirement, negotiations, mediation before the National Mediation Board ("NMB"), and voluntary binding arbitration. See 45 U.S.C. §156; Detroit & T.S.L.R.R. v. United Transp. Union, 395 U.S. 142, 152-53 (1969).[1]

When originally enacted in 1926, the RLA applied only to labor disputes involving rail carriers. Ten years later, recognizing that "anything which makes for stability in the labor relations and good morale of the railroad industry applies also to the flying industry," Congress amended the RLA to include the then nascent, but growing air transportation industry. Report of Senate Committee on Interstate Commerce on S.2496 with Amendments, 74th Cong., 1st Session, May 13, 1935 (quoting O.S. Beyer, Director, Section of Labor Relations, Federal Coordinator of Transportation). Accordingly, with but one minor exception,[2] the 1936 amendments made all the existing provisions of the RLA applicable to air carriers, including the Section 6 procedures to be followed whenever carriers wish to implement changes in existing collective bargaining agreements. See 45 U.S.C. §§181, 182; see generally Air Line Stewards and Stewardesses Ass'n v. Trans World Airlines, 173 F.Supp. 369, 374 (S.D.N.Y.), aff'd, 273 F.2d 69 (2nd Cir. 1959), cert. denied, 362 U.S. 988 (1960). In amending the RLA, Congress clearly "intended to make air carriers and their employees integral parts of the legislative pattern of the Railway Labor Act." Id. at 374; see also Int'l Ass'n of Machinists v. Central Airlines, 372 U.S. 682, 685 (1963) ("aim

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[1] Additionally, Section 2, Seventh, 45 U.S.C. §152, Seventh, prohibits carriers from changing the "rates of pay, rules, or working conditions of its employees" during the term of an existing collective bargaining agreement except as prescribed in such agreements or the RLA's major dispute resolution processes embodied in Section 6.

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[2] The lone exception is Section 3, 45 U.S.C. §153, which established the National Railroad Adjustment Board to handle disputes involving the interpretation or application of existing collective bargaining agreements. In its stead, Congress empowered the NMB to create a National Air Transport Adjustment Board whenever, in the NMB's judgment, such a board became necessary for the prompt and orderly settlement of disputes. See 45 U.S.C. §185. Because both the air carriers and unions have preferred to maintain local system boards for grievance handling and resolution, the NMB has, in fact, never created such a national board. Rehmus, at pg. 14.

[of RLA] was to extend to air carriers and their employees the same benefits and obligations available and applicable in the railroad industry"); Vaughter v. Eastern Air Lines, 619 F.Supp. 463 468 (D.C. Fla. 1985) (same), aff'd, 817 F.2d 685 (11th Cir. 1987); Air Line Stewards and Stewardesses Ass'n v. Northwest Airlines, 267 F.2d 170, 173 (8th Cir.) ("it was the intention of the Congress... to give the same [protections] to employees engaged in air transport as ... [those] engaged in railroad employment"), cert. denied, 361 U.S. 901 (1959).

The very same public policy concerns - labor stability and the avoidance of disruption of vital public transportation services - that led Congrss to enact the RLA and then amend it to include the airline industry also led Congress to enact Section 1167 of the Bankruptcy code, 11 U.S.C. §1167.

Section 1167 provides that, notwithstanding the executory nature of collective bargaining agreements and the Code's other provisions governing the rejection of executory contracts, see 11 U.S.C. §365, "the wages or working conditions of employees established by a collective bargaining agreement that is subject to the Railway Labor Act" may not be changed during a Chapter 11 reorganization except in accordance with the detailed processes for dispute resolution found in Section 6 of the Railway Labor Act. In making such an exemption for RLA collective bargaining agreements, Congress recognized that

> [t]he subject of railway labor is too delicate and has too long a history for this code to upset established relationships. The balance has been struck over the years. [Section 1167] continues that balance unchanged.

House Report No. 95-595, 95th Cong., 1st Sess. 423 (1977) (as quoted in Legislative History of Section 1167, Bankruptcy Code, Collier Pamphlet Edition, part 1, at page 736 (1988)).

By its express terms, Section 1167 applies to "all collective bargaining agreement[s] ... subject to the Railway Labor Act." (emphasis added). Moreover, the language of §1167 is significantly broader than that of its predecessor, Section 77(n), which spoke only of changes in the wages or working conditions of railroad employees. Furthermore, Section 77(n) was enacted in 1933, three years before the RLA was amended to include air carriers. Indeed, two commentators from the Wharton Industrial Research Unit of the University of Pennslyvania, a group which provides materials for the national and international business communities, have concluded that the expanded language of §1167 was meant to reflect the expanded coverage of airlines under the RLA. See T. Haggard and M. Pulliam, Conflicts Between Labor Legislature and Bankruptcy Law, Labor Relations and Public

Policy Series, No. 30, at pg. 23 (Univ. of Pa. 1987) ("[i]n light of the inclusion of air carriers in the RLA in 1936 and the express language of section 1167, it is difficult to discern a basis for treating air carriers differently from railroads for bankruptcy purposes").

Nonetheless, Section 1167's placement in Subchapter IV of Title 11, a seciton of the Code that deals exclusively with railroad reorganizations, has created some confusion as to its applicability to the airline industry. Accordingly, the few reported judicial opinions are split as to §1167's applicability to the air industry. Thus, in In re Overseas National Airways, 238 F.Supp. 359 (E.D.N.Y. 1965), the court held that even under the narrower language of §1167's predecessor, Section 77(n), the referee in bankruptcy was without power to reject a collective bargaining agreement because the Railway Labor Act "prescribes the exclusive means by which such rejection may be effected." Id. But see In re Air Florida System, 48 B.R. 440, 443 (Bankr. S.D. Fla. 1985) (holding that §1167 applies only to rail reorganizations because of its placement in Subchapter IV); 11 U.S.C. §103(g) (Subchapter IV applies only to cases concerning a railroad).

The need to end this confusion and amend §1167 to specifically include the airline industry thus becomes manifest. The identity of purpose of the RLA, its 1936 amendments and Section 1167 of the Bankruptcy Code - the promotion of labor stability in the transportation industry - is patently clear. Since there is no rational policy basis for including rail but not air carriers, and thereby creating a loophole through which the important statutory purposes of the RLA can be undermined, Section 1167 should be amended as proposed.

2. Statement Demonstrating Constitutionality of S.544.

Under well-settled principles of Constitutional law, Senate Bill 544 ("S.544") is clearly a proper exercise of Congressional authority under the Bankruptcy Clause. This Clause of the Constitution provides that Congress shall have the power to "establish ... uniform laws on the subject of Bankruptcies throughout the United States," U.S. Con., Art. I, §8, cl. 4.

The "uniformity" requirements of this provision demand only that a statute apply uniformly to a defined class of debtors. *See* *Blanchette* v. *Connecticut General Ins. Corp.*, 419 U.S. 102, 159-60 (1974). Thus, Congress is permitted to apply a bankruptcy law to a particular industry or even to a particular geographical region. For example, in *Blanchette*, the Supreme Court upheld Congress' response to an existing rail transportation crisis by enacting legislation which applied to the reorganization proceedings of only eight major railroads and 15 leasers of leased lines in a particular geographical region of the country. *Id*. at 108, n.3, 159-60.

S.544 fully comports with this "uniformity" requirement. The bill's provisions would apply without exception to *all* air carriers and to *all* collective bargaining agreements in the airline industry.

The proposed legislation also clearly passes scrutiny under the "Taking" Clause of the Constitution which states that private property shall not "be taken for public use, without just compensation." U.S. Con., amend. V. To determine whether property has been improperly taken "necessarily requires a weighing of private and public interests." Agins v. Tiburon, 447 U.S. 225, 261 (1980); see also Andrus v. Allard, 444 U.S. 51, 65 (1979) (Taking clause preserves "government's power to regulate subject only to the dictates of 'justice and fairness' (citation omitted)).

Here, the provisions of the bill requiring a substantive consolidation of the controlled group of an air carrier which files under Chapter 11 would promote substantial governmental interests while interfering only minimally with private property interests. As noted in the oral testimony of Captain Henry A. Duffy, substantial and legitimate public interests pertaining to safety and the avoidance of disruption in the airline industry and the rights of creditors to reach assets of corporations related to a debtor in Chapter 11 would be served by sections 4 and 5 of the proposed law. See, e.g., Penn Central Transp. Co. v. City of N.Y., 438 U.S. 104, 125 (1978) (Government regulation promoting health, safety or general welfare will be upheld even if it "destroys or adversely affects recognized real property interests"); see also Keystone Bituminous Coal Ass'n v. DeBenedictis, 107 S.Ct. 1232, 1242 (1987) (upholding against Fifth Amendment challenge, statute regulating land use to accomplish public interests); Goldblatt v. Town of Hempstead, 369 U.S. 590, 595 (1962) (ordinance passed as safety matter not a taking).

On the other hand, substantive consolidation would cause no undue interference with the economic interests of creditors and shareholders of the "controlled group of corporations" as defined in section 4(2) of S.544. First, no taking can be found as to these creditors and shareholders since the proposed statute would not require the "Government to invade or permanently appropriate any" of the group assets "for its own use," Connolly v. Pension Ben. Guar. Corp., 106 S.Ct. 1018, 1026 (1986), but instead would only adjust the "benefits and burdens of economic life to promote a public good." Penn Central, 438 U.S. at 124; see also DeBenedictis, 107 S.Ct. at 1244 n.18 (same); Andrus, 444 U.S. at 65 ("government regulation -- by definition -- involves the adjustment of rights [which often] ... curtail some potential for the use or economic exploitation of private rights").

Second, the economic impact on the affected class of creditors and shareholders would be minimal or moderate at best. As an initial matter, no evidence exists that this proposed statute for substantive consolidation would abridge any secured interests. Even at Eastern, there has been no demonstration that secured interests at TAC, Jet Capital or Continental would be impaired by S.544.

Third, as to the unsecured interests, any possible interference with their contract rights caused by this bill would not constitute a taking. See Kuehner v. Irving Trust Co., 299 U.S. 445, 451-52 (1937) (in upholding amendments to bankruptcy code which limited the claim of a landlord for indemnity, the Supreme Court noted that the landlord had no lien and that there was a "significant difference between a property interest and a contract and that the constitution does not forbid impairment of the obligation of the latter").

Fourth, even if any of the affected class, whether secured or unsecured creditors, could show an interference with any economic interest caused by S.544, they surely would be unable to show any "deprivation significant enough to satisfy the heavy burden placed upon one alleging a regulatory taking." DeBenedictis, 107 S.Ct. at 1246. The Supreme Court has repeatedly emphasized that if the legislation merely causes, as here, at most a reduction of the value of an investment, this impact is not equated with a taking. See Andrus, 444 U.S. at 66; Jacob Ruppert v. Caffey, 251 U.S. 264, 303 (1920); see also Andrus, 444 U.S. at 66 (loss of future profits "provides a slender reed upon which to rest a taking claim").

Finally, creditors and shareholders of a controlled group of corporations should be aware of the fact that a bankruptcy court has the equitable authority to substantially consolidate related corporations and pool their assets into a common fund against which the creditors of all entities can assert their claims. See, e.g., In re Tureaud, 45 B.R. 658, 661-62 (Bankr. N.D. Okla. 1985), aff'd, 59 B.R. 973 (N.D. Okla. 1986). The proposed bill would thus be doing no less than what the courts are already empowered to do, except that S.544, based on the concerns as expressed in prior testimony pertaining to the airline industry, would be providing general rules requiring substantive consolidation whenever an air carrier files for Chapter 11 protection. Hence, investors in a controlled group of corporations already face the possibility of a substantive consolidation. Because this group's expectations would not be unduly undermined by passage of S.544, this legislation would not constitute a taking. See Connolly, 106 S.Ct. at 1027 (no taking where reasonable expectations of plaintiff not upset); see also Penn Central, 438 U.S. at 124.

This same analysis also demonstrates that the sections of S.544 which bring labor contracts in the airline industry under the provision of §1167 of the Bankruptcy Code also satisfy the requirements of the Taking Clause. As Captain Henry A. Duffy stated in his testimony, the purpose of this amendment to §1167 is to advance the substantial and important government interest of promoting labor peace and avoiding disruption in the airline industry. In addition, the economic impact on creditors would be minimal. First, this amendment would be unlikely to impair any secured interest. And, while enactment of these sections of S.544 would preclude rejection of a collective bargaining agreement, it would not prevent changes of the terms of a labor contract made in accordance with Section 6 of the Railway Labor Act.

None of the above analysis is affected by the fact that the effective date of S.544 is March 8, 1989 and that it applies to "any case or proceeding filed on or after such date," such as Eastern. As the Supreme Court has explained, where, as here, Congress is regulating commercial and economic benefits and burdens, the test for satisfying constitutional scrutiny is minimal even when the legislation is retroactively applied:

> "[T]he strong deference accorded legislation in the field of national economic policy is no less applicable when that legislation is applied retroactively. Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches."

Pension Ben. Guar. Corp. v. R.A. Gray & Co., 467 U.S. 717, 729 (1984).

Here, the retroactive application has clear justifications. First, applying §1167 to the Eastern situation will help stabilize labor relations between Eastern and its pilots and flight attendants, without imposing undue burdens on Eastern. As previously stated, Eastern will still be able to change the terms of its labor contracts in accordance with the RLA. Second, substantive consolidation at Eastern is a rational means of spreading the cost of the Eastern bankruptcy among the creditors of Eastern and its controlled group of corporations. As Captain Duffy addressed in his testimony, Eastern has engaged in numerous well-documented transactions with TAC and Continental which have adversely affected Eastern's financial condition while benefiting the financial condition of TAC and Continental. S.544, by considering all these corporations which benefited from these deals as part of Eastern for purposes of creditors' claims, is a reasonable response to those transactions. Cf. Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 18 (1976) (imposition of retroactive liability on coal operations for employees with black lung disease is reasonable measure for sharing costs of its "employees' disability to those who have profited from the fruits of their labor -- the operators and the coal consumers"); Travelers Ins. Co. v. Marshall, 634 F.2d 843, 848-49 (5th Cir. 1981); see also Kuehner, 299 U.S. at 452 (upholding bankruptcy legislation that affects "the creditor's remedy for its enforcement against the debtor's assets, or the measure of the creditor's participation therein, if the statutory provisions were consonant with a fair, reasonable and equitable distribution of those assets").

In addition, as noted previously, secured interests of Eastern's control group creditors will unlikely be affected by S.544. And, even if secured interests were effected, the economic impact of the legislation on secured (and unsecured) interests would not be unduly burdensome since at most only the value of the investment would be reduced. Finally, even if creditors of TAC, Continental and Jet Capital expected that they would be insulated from an Eastern bankruptcy -- _but see supra_ pp. 10-11 -- the bankruptcy court could substantively consolidate Eastern, TAC, Continental and Jet Capital -- retrospective application would not offend Constitutional principles. _See Usery_, 428 U.S. at 15-17 (Retroactive legislation presumed constitutional and that such legislation "readjusting rights and burdens is not unlawful solely because it upsets otherwise settled expectations ... This is true even though the effect of the legislation is to impose a new duty or liability based on past act").

In sum, S.544 clearly falls well within the authority granted to Congress by the Bankruptcy Clause and satisfies all of the requirements imposed by the Constitution for economic regulation whether applied prospectively or retrospectively.

QUESTIONS SUBMITTED BY SENATOR DECONCINI REGARDING S. 544

QUESTIONS FOR HENRY A. DUFFY

1) Mr. Duffy, you state that the parent-subsidiary structure in the airline industry raises public policy concerns not currently addressed by the Bankruptcy Code. If this is so, why should the proposed section 109 amendment be limited to the airline industry if the problem of protective corporate structuring is prevalent throughout all industries?

2) In your written statement you assert that S. 544 will result in fiscal responsibility by all members of an airline control group, and that in the event of an airline's bankruptcy, both secured and unsecured creditors of an airline would be better protected.

Although section 4 of S. 544 would offer more protection to a creditor of a bankrupt airline, would it also result in less protection of creditors investing in the affiliates?

AIR LINE PILOTS ASSOCIATION
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March 30, 1989

Honorable Howard Metzenbaum
U.S. Senate
Washington, D.C. 20510

Dear Senator:

Enclosed are my written responses to two questions submitted by Senator DeConcini in connection with the March 17th Senate Judiciary Committee hearing on S. 544 at which I testified.

Sincerely,

Henry A. Duffy

Henry A. Duffy, President

HAD:sk

ANSWERS TO SENATOR DECONCINI'S QUESTIONS

1. While the proposed section 109 amendment may help other industries, ALPA believes that it is of particular importance for the airline industry. The enhancement of air safety and the avoidance of labor disruption are important public policy goals. Both of these, along with protecting creditors' rights would be end results of the section 109 amendment.

Deregulation of the airline industry has resulted in tremendous upheaval for airline management, employees, shareholders and investors. Since 1979, 78 airlines have filed for protection under Chapter 11 of the Bankruptcy Code and 115 airlines have ceased operations. Today's ten major airlines are the products of various mergers which have taken place in the last few years. Some airline holding company structures, such as UAL Corp. (formerly Allegis) and Pan American Corporation have recently undergone significant changes. The section 109 amendment would thus reduce the volatility of the airline industry, by reducing the number of bankruptcies in the industry and improving the two key areas of air safety and labor stability.

First, a financially weakened carrier cannot afford to maintain or replace its aging aircraft fleet, thus creating serious airline safety problems. Potential investors would be encouraged to fund replacement aircraft knowing that they would be protected in the event of bankruptcy. Further, members of the controlled group would be less likely to undertake strategies which could prove to be financially burdensome for an affiliate and consequently, a financially viable structure would be maintained.

Second, an airline finding itself in financial problems would, in an attempt to remain viable, turn more and more to its unions seeking larger wage and working condition concessions. The unions would eventually react unfavorably to this continuous demand for concessions, creating a labor disruption which could negatively affect the traveling public. By encouraging all members of the control group to practice fiscal responsibility, the proposed amendment would reduce the chances that one member be financially weakened and thus, avoid potentially serious labor disruptions.

2. Creditors of all the affiliated corporations within a control group would be protected by substantial consolidation. The shell game of shifting of assets among affiliated corporations acts as a potential threat to the value of creditors' investments in any one of the corporations within the control group. All creditors therefore will have their investment risk lowered by S. 544.

As we previously stated, this bill would encourage fiscal responsibility among the control group and would deter fiscal practices which improperly remove assets from one affiliate to the detriment of its current creditors. S. 544 would thus boost investor confidence and avert bankruptcies to the benefit of all corporate creditors.

ALPA feels that the benefits of averting bankruptcy and preventing the devaluation of investments far outweigh any potential greater risk caused by this bill to unsecured creditors who invested in an affiliate prior to enactment of S. 544. It is important to note that after S.544 is known to exist, all potential subsequent creditors of an affiliate would be able to assess any additional risk which might be created by a potential subsequent consolidation.

Senator METZENBAUM. Mr. Winpisinger, if there were a board appointed, as has been done in 34 preceding cases in the airline industry, would the Machinists go back to work?

Mr. WINPISINGER. Yes, sir, if there was no other constraint that prevented it. We are ready, willing, and able to do it, tomorrow morning as a matter of fact.

Senator METZENBAUM. And second, assuming that you did not have a board, it is my understanding that if there were voluntary binding arbitration, an impartial arbitrator to make a decision as to what the contract should be—which is done in many other labor matters—would the Machinists agree to binding arbitration?

Mr. WINPISINGER. Absolutely. We long ago did agree to that at the time that—binding arbitration of all outstanding issues under our section 6 notice was offered by the National Mediation Board, which is their final step before finishing up their file on the case, and we agreed at that time to accept it. The carrier refused, so it did not occur.

Senator METZENBAUM. And there would have been no cessation of work had that occurred?

Mr. WINPISINGER. No. In that case it would have solved the problem.

Senator METZENBAUM. But if there were binding arbitration now, and the employer was willing to enter into such an agreement you would return to work?

Mr. WINPISINGER. We have no reason to change our position. We would continue on that path.

Senator METZENBAUM. Which means you would return to work?

Mr. WINPISINGER. Yes.

Senator METZENBAUM. Now let me ask you a question, Mr. Simon, because I understand you are involved in the bankruptcy matter. In a matter of bankruptcy where the airline has petitioned for reorganization, is it my understanding that the airline continues to operate normally—except it does not have to pay its creditors for a period of 90 days? Or can there be a trustee for the creditors appointed at an earlier point?

Mr. SIMON. Yes, no, and yes. When a Chapter 11 petition is filed, the company's management remains in control of the ordinary course of business of the carrier. Debts that were incurred before the filing of the petition, which are called pre-petition debts, or pre-petition obligations of the company, may not be paid until the conclusion of the Chapter 11 case, and the emergence of the carrier from Chapter 11 under a plan of reorganization, with a footnote.

The footnote is despite a number of court of appeals 'decisions, holding clearly that they should not do so, bankruptcy courts, traditionally, in the first day or two of major Chapter 11 proceedings, occasionally permit payment of pre-petition obligations as I have described, and in fact one of the orders signed on the first day of the filing of the Eastern bankruptcy was an order signed by the bankruptcy judge permitting the pre-petition wages of the strike breakers to be paid, but not permitting the wages owed, the wages that were earned in the weeks before the Chapter 11, to be paid by those who were either striking or respecting, lawfully, the picket lines established by other individuals.

Indeed, at any time in the case, a bankruptcy court may appoint an outside independent trustee to replace management that is found to be either incompetent, fraudulent, or otherwise demonstrating an incapacity to run the business.

And in fact the Air Line Pilots Association has filed a significant motion with the bankruptcy trust, with the bankruptcy court, asking that such an independent trustee—not beholden to Mr. Lorenzo, not beholden to the unions, but beholden only to the bankruptcy judge—be appointed to run the business.

Senator METZENBAUM. And what has been the court's disposition of that motion?

Mr. SIMON. The motion has been set down for hearing on April 7th. In an effort to preempt that, the management has filed a motion for something less than a trustee, in effect a monitor called an examiner. That matter is on for hearing on an order to show cause before the bankruptcy court next week.

We have suggested to the bankruptcy court that it merge those two applications, one for an examiner, the other for the trustee, either on the early date that has been appointed for the motion for an examiner, or on the later date for the return date of the motion for trustee.

Senator METZENBAUM. Mr. Winpisinger, the Machinists were employed through March 3. Have those workers been paid for the work they performed?

Mr. WINPISINGER. No, Senator. Mr. Lorenzo has duplicated in this situation exactly what he did on Continental back in 1983. He declared bankruptcy on the morning of payday, and therefore, the pay claims of our members are submitted to the bankruptcy court as we understand it.

Senator METZENBAUM. So they did not get paid. Was that a 2-week check or 1-week check?

Mr. WINPISINGER. I think it was 1 week that was due, and we were told we would get, but that morning, all bets were off.

Senator METZENBAUM. What about the current status of their health-insurance coverage in light of Eastern's bankruptcy?

Mr. WINPISINGER. It is our understanding—and obviously, we have to gather this information in less than absolute channels—but it is our understanding that no premiums have been paid by the carrier for some 3 months now, and that the insurance—insurer is therefore considering not honoring any claims from anyone for the time period even up to the strike, a time period preceding the strike date by some period unidentified to us. And that is because there are premium delinquencies.

Senator METZENBAUM. Apart from the wages, pension benefits may be the most important and substantial benefit owed to workers. How has this control group liability for pension benefits affected the status of Eastern's pension liabilities to its workers?

Mr. WINPISINGER. Well, I am not—you know—some of this gets a little beyond my ken because we cannot put our finger on precise, absolutely correct information. But I would conclude from all of this—for example—that the pension liabilities would be secured by access under the appropriate statutes to Texas Air, and perhaps even beyond, to be satisfied.

And I do not know what the current posture is in terms of the payments. We are told that there is something on the order of a $750 million liability that PBGC would have to pick up if it evaporated, but we believe that the assets of the control group can satisfy that claim. Over time. We do not know when.

Senator METZENBAUM. What you are saying is, that if the bankruptcy is concluded in the manner in which it is presently proceeding, it has been reported that the Federal Government—the Pension Benefit Guarantee Corporation—would have to pick up a $750 million liability?

Mr. WINPISINGER. Except to the extent that they do have the statutory authority to reach into the control group and try to satisfy that claim, and we do not know with what degree of success, obviously.

Senator METZENBAUM. And I think perhaps your lawyer would want to answer this. But if that $750 million claim has to be asserted, then under ERISA, the PBGC would have the right to do the very thing that this bill contemplates for all the creditors, that is, to reach all of the assets of the parent as well as the affiliated companies.

Is that your understanding, Mr. Guerrieri?

Mr. GUERRIERI. That is our understanding, Senator Metzenbaum. That in fact S. 544 borrows the very language concerning "control group" from the amended Internal Revenue Code, to do nothing more, really, than what the Internal Revenue Code allows already—that is, to reach the assets of the parent.

In fact in a number of instances where Eastern applied for pension waivers, the PBGC required Texas Air to become a guarantor of those waivers, and for that reason we believe that this bill, in effect, creates a certain symmetry between what is currently in place under the Internal Revenue Code and what should be recognized in the bankruptcy laws as well.

Senator METZENBAUM. Captain Duffy, you testified that public safety is at risk when an air carrier becomes under capitalized. Can you point to specific instances, or more general evidence that Eastern is less safe since Texas Air began stripping away its assets?

Captain DUFFY. Mr. Chairman, I think this, probably more than any other, is an example of why it is so critically important to the traveling public. After the Texas Air takeover in early 1986, we noted a drawdown on the spare parts inventory.

The way the pilots saw it was, suddenly, the maintenance carryover items, the items that do not get fixed, were suddenly starting to skyrocket. Between September 1986 and September 1987, they were starting to average 350 to 450, per day, maintenance carryover items, and just so you get a comparison, Delta and U.S. Air would have like 50 or a hundred.

And the reason for that was not enough spare parts to fix the airplanes. Now the way the pilots see that, again, is we are approached by management to take an airplane that we think should be fixed, to the next maintenance base, or the next maintenance base, or we will fix it tomorrow. Certainly the traveling public does not expect that. They expect whole airplanes that operate the way they are supposed to, and it is a graphic example of transfer of parts, or insufficient investment in parts, and it does directly affect safety.

Senator METZENBAUM. Your testimony includes an addendum analyzing the constitutionality of S. 544. Rather than take the time at this moment, Mr. Simon, in the event the constitutional question is raised at a later point in this hearing, would you be good enough to remain available so that we might bring you back to respond if that claim is made?

Mr. SIMON. Certainly, Senator.

Senator METZENBAUM. Thank you. Now Captain Duffy, in 1984, Congress modified the bankruptcy law to limit a debtor's ability to reject collective bargaining agreements in a chapter 11 proceeding.

Why should we now apply the provisions of the Railway Labor Act rather than those of the 1984 law to airline bankruptcies?

Captain DUFFY. Since my general counsel was a part of the negotiations that took place in the final stages of that, I had better pass that to him.

Mr. SIMON. I remember spending—I guess it was from 6:00 in the evening till 3:00 the next morning in joint conference, and remember well, Senator Thurmond's vigorous participation in the bill that resulted in the additional judgeships, and Section 1113. I think it is fair to say that the passage of 1113 was a direct outgrowth of the Supreme Court's decision in *Bildisco* which was a case involving the National Labor Relations Act. Indeed, the National Labor Relations Board, and, historically, the Congress has distinguished between the transportation industry and the airline and railroad components of it and the rest of American industry.

Section 1113 did not focus on the Railway Labor Act 1167 problem which S. 544 seeks to address. We think that while Congress did the job that it did, and did with alacrity and a good deal of balancing of respective interests in 1984 in Section 1113 of the code, it did not intend to address the Railway Labor Act provision which had been in the Act for 50 years.

Senator METZENBAUM. Thank you. Thank you very much. Senator——

Mr. WINPISINGER. Mr. Chairman, might I amplify one of my prior responses just one tiny little bit so that the record is perfectly clear.

Senator METZENBAUM. Please do.

Mr. WINPISINGER. You asked me about returning to work, the willingness of our members to go back. It is an unequivocal yes. Implicit in your question I believe was the notion that they would go back under the terms and conditions of the contract that was in effect, and is status quo in effect. Absolutely.

Senator METZENBAUM. I appreciate the clarification, but that was implied in my question. The chairman is not quite certain what protocol calls for when you have the actual chairman of the committee to my right, and the Ranking Minority member to my left.

The CHAIRMAN. The chairman can tell you, always yield to the gentleman from South Carolina. The wisest thing to do at all times. And I might say to Mr. Simon, you are lucky that meeting that you referred to did not go until 5:00 o'clock in the morning because the later it goes, the wiser and better Thurmond gets, so——

Mr. SIMON. The number of judgeships I think in the bill reflected exactly that, Mr. Chairman.

Senator METZENBAUM. Senator Thurmond, if we have not killed you with kindness up to this point, please proceed.

Senator THURMOND. I want to thank you both for your gracious remarks.

This question can be answered either by Mr. Winpisinger or Captain Duffy. The recent bankruptcy filing by Eastern Airlines has served to highlight the dispute between labor and management.

The question is, why do you believe that the Government should involve itself in a private-sector dispute?

Mr. WINPISINGER. Well, we do not believe that is the connotation, Senator, that is implicit in this situation. The fact is that the President of the United States has the statutory prerogative, after the Mediation Board has exhausted its efforts to arrive at an amicable solution, to appoint an emergency board which, in effect, is a panel of outside experts in labor relations and industry affairs, who take testimony, adduce evidence, compile a record, and are obligated to make to the President a report which embraces their recommendations for the settlement of the dispute, whereupon the parties are free—factfinding I think is a good colloquialism for it, and the parties thereafter are free to embark on negotiations based upon those recommendations to reach a solution.

It has worked in an enormously high percentage of the cases in the past, and we do not see any reason why it would not work in this one.

Captain DUFFY. Senator, if I might add: You know, I think the Government already has involved itself, the bankruptcy court being an arm of the Government.

For the pilots, the congressional bill creating the emergency board presents an opportunity for global labor peace at Eastern Airlines, which it has sorely needed for some years.

Both the transport workers and the pilots have said that they would gladly submit to the emergency board stepping into their negotiations to give us a settlement along with the Machinists, so that once and for all, on Eastern Airlines we had labor peace, that we could look forward to smooth operations of the company.

Senator THURMOND. Mr. Winpisinger, aside from the current labor dispute between the management of Eastern Airlines and its unions, what industry-wide benefits do you believe will accrue if S. 544 is enacted?

Mr. WINPISINGER. Industry-wide benefits? I think they would parallel exactly the redress that is sought here. I think it in effect—in one word—would revise the 1984 statute amendments to require carriers that up-stream their assets to parent corporations, also upstream their liability for the protection of the creditors, and it is just about as simple as that.

Senator THURMOND. Now I might propound this question to both of you, if you will kindly answer it.

Some claim that Eastern Airlines has sold off assets solely for the benefit of Texas Air and its Continental subsidiary. Assuming harm to employees, do you believe that amendment of the bankruptcy code is a proper way to deal with such harm? Why, or why not?

Captain DUFFY. Senator Thurmond, I think it removes the insulation, in this case from Frank Lorenzo, who has several layers between him and the harm done by the bankruptcy. He has been able to up-stream, as we keep saying, the assets. He insulates those assets inside the next corporation up, Texas Air, sometimes all the way up to Jet Capital, yet, when he collapses the lower corporation in this chain—none of that reaches up to him.

And let me touch the wider implications of this, because we have some managements who always look on success as the next vehicle that they might use. If they see this as a successful technique in the airline industry, we no doubt will see others try it, and I do not think anybody would want what has happened to Eastern Airlines to happen to any of the other major carriers, or any of the carriers in this industry.

Mr. WINPISINGER. I would simply add to that, Senator, that we believe it to be in the public interest, that creditors get satisfaction of their legitimate claims by attacking whatever entity there is in the whole ball of wax that can satisfy their claims.

And in addition to that, it would insulate employees from bearing the brunt of bankruptcy. An employee is at the very bottom on any of his claims, or her claims—at the very bottom of the pecking order in terms of getting their claims satisfied.

And that being the case, by this kind of an amendment the employees are in essence removed from the proceeding except to the extent that they sit down under the auspices of the Railway Labor Act and revise their agreements.

Senator THURMOND. Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you, Senator Thurmond.

Senator THURMOND. Thank you, gentlemen, for your appearance.

Senator METZENBAUM. We will be very pleased to now hear from the chairman of this committee.

The CHAIRMAN. Mr. Chairman, let me begin by complimenting you on taking the initiative to begin to explore what, quite frankly, needs to be explored. I know full well your assertion—and I think it is correct—that your legislation is obviously not intended to respond to a single situation, a single bankruptcy. But let me speak not for you nor for the legislation, but let me speak for me.

One of the underlying questions I have here is, has Mr. Lorenzo found out a way to bastardize the Bankruptcy Code? Is he out to do what others may learn to do? I may be wrong, but as a lay person looking at this, it seems to me that there at least can be raised the question whether or not the Bankruptcy Code is being abused; whether or not there is an intention to deliberately use it in ways that promote one's own gain, when it is not necessary.

I recall, I will say on the record, some of the very people before me came by to see me to discuss this legislation with me, and I told them I was not at all sure of it, and, in turn, you and others feel strongly about it. I was not sure. I came to listen. But I found something interesting.

Two of the three men sitting in front of me told me, 3 weeks ago, that immediately upon this thing being engaged, what would happen would be that Mr. Lorenzo would declare bankruptcy, and I looked at them and said, oh, come, on, come on, you are overstating your case.

This committee, can not and should not target any single incident or single person, but I, as chairman of the full committee, am entertaining the notion of spending a lot of time looking at Mr. Lorenzo in terms of maybe he can shed some light for us on how this all works, in the same way we look at leveraged buyouts being abused, or not abused, as he seems to have mastered a new means. You know, I was recently on a college campus and a young man said, "You know, what we really need is businessmen to run the country. If we had a businessman as President we wouldn't be in trouble."

Well, it seems to me the key to success is bankruptcy, and so I am very curious about all of this. I am not at all certain about where I am on this legislation but I am certain that something has to be done. I am not sure what it is.

So I want to say, at the outset, that where I—as the young kids say—where I am "coming from" on this, it seems to me that we have unnecessarily been put through—we, the consumer, we the travelers—have been unnecessarily put through something that could have been avoided, at least for 60 days.

Labor has gotten the "rap" for this, in my view unfairly, as they have said they are willing to have gone into the process. The President, after being petitioned by Senator Kennedy, who was our leader on this issue—and 35 other Senators, including myself—wrote to President Bush to request the appointment of an emergency board, but no board was created. However, President Bush has the power to do that, based on a recommendation that would come to him from other sources. He is the first President, I think in 35 years or so, not to do that.

And so my antennae is up a little bit here. I am not sure what is going on. In my view it is necessary to put the events that have occurred in the past 2 weeks in some kind of perspective. and this hearing—I hope will demonstrate—that the time period that we must consider is not merely the past 2 weeks, and the company that we must consider is not merely Eastern Airlines, but the industry as a whole, and the Bankruptcy Code as a whole.

In my view, we have to look at the events that have occurred during the past several years involving a number of different companies. Eastern, as many of us know, as was pointed out, is owned by Texas Air, which is owned by Frank Lorenzo. Mr. Lorenzo owns Continental, and so on. We went through all of that.

In assessing the current dispute I believe we must go back at least to 1983, and maybe even before that, to begin to try to figure out how we, as a Nation, are going to figure out how we can better provide for what is obviously an essential element and component of this Nation's strength, economic as well as its political strength.

And that is, being able to provide air transportation and yet not have people victimized as a consequence, either in the air, or through contracts, or abrogation of contracts.

And the question I had back in 1983, and the question I have now is whether the Bankruptcy Code is being misused in ways that Congress never intended.

For example, have transactions been undertaken to harm Eastern in such a way as to drive it into bankruptcy? Was Eastern's sale of its computer reservations system to Texas Air for $100 million fair, or was it some kind of sweetheart deal?

These are things I want to look at, not just in this hearing, but I want to look at as chairman of this committee.

I believe it is incumbent upon the Congress to determine whether the Bankruptcy Code is being misused and manipulated in this day of increasingly complex corporate transactions, and I believe that our duty is to take corrective steps, if we conclude that it has been misused.

I make no final judgment on these points, but I must tell my colleagues on the committee, that it is not something that I intend on—notwithstanding how useful these hearings are—intend to let rest.

So I invite the corporate community to know that it is something I would like to talk about, and I invite the broader labor community to let them know it is something I would like to talk about.

Let me speak to you, Mr. Simon, for a minute, if I may. You are all fine men, except you have all gone down one notch in my esteem. It is Saint Patrick's Day. You know that the chairman of this committee is Irish, and you were not even smart enough to wear any green, which lets me know that you are not as savvy as people think labor leaders are, and I hope the business people are a little wiser when they come up, and have a little bit of green on.

And you are just lucky Kennedy is not here. [Laughter.]

But let me be serious for a few moments. Mr. Simon, let me ask you a question about the scope of section 4 of this bill, if I may, and the reason I direct it to you—you and I have had a chance to talk before, and, quite frankly, this is not to help you in your negotiations with your employer, but you are one of the most articulate people I have ever spoken to on this subject in the 16 years I have been here, and so that is a nice way of telling you you had better have a good answer for this one.

Mr. SIMON. Notwithstanding the tie.

The CHAIRMAN. Notwithstanding the tie. In your case, I can understand a little bit. Duffy's, I have real trouble. [Laughter.]

Now let me say, get serious again. I can conjure up two kinds of situations in which this section 4 of the bill might apply. In one case, a subsidiary files for bankruptcy, and the parent company would also be deemed to have filed. That is how it would work in one case.

In the second case, a parent company files for bankruptcy and its subsidiaries are also brought into chapter 11.

Now would section 4 of the bill deal with both these situations—the situation of the subsidiary filing, bringing in the parent, and the parent filing and bringing in the subsidiary?

And if so, would the impact be the same in both cases?

Mr. SIMON. The answer to both questions I believe is yes. I think it is clear that the bill is designed to and I think does work both ways—parent to subsidiary and subsidiary to parent—and I think the reason that it does, and the reason it should is inherent in the issue itself. Either we are right, that there is a potential for mischief, not only in the instance on the board before us this morning, but also, in view of the increasingly complex matrix of companies that have developed in modern corporate existence, or we are wrong.

And if we are right about that, then the issue of control—both ways—whether one is controlled, or one is doing the controlling enters into the question of what pool of assets should be available to meet which claims of which creditors?

And if we are right that in the airline industry, in particular—because of the overriding air safety and public transportation aspect of the situation—that the traveling public and the people who fly in the planes, and the people who look to the airline companies for satisfaction of their debts ought to have available what even the Department of Transportation in the fitness examination of the Texas Air family of corporations saw, is the full bundle of assets.

And that bundle of assets, and those bundles of debts, should be viewed in much the same way as we like to think we view an air transportation company. That is, a company that not only provides airplanes and employees, but services, maintenance services, reservations services, marketing services.

And if we are right, that it is in the interest of all of those constituencies, for those bundles to be treated as such, and not try, in a false, cosmetic way, to carve the bundle up into little baskets, some of which are undernourished, and others of which are overly enriched, then we think that section 4 is designed to, and does address those problems.

The CHAIRMAN. It may address those problems, but it not only has an impact on the transportation industry, but has a significant impact upon the way in which American business has developed over the past 40 years.

The reason I ask the question is this: That in the case of Eastern, it quite clearly involves a voluntary filing for bankruptcy. Eastern voluntarily filed. But what would be the impact of section 4 of the bill in an involuntary context?

Mr. SIMON. There, too, the way it is drafted, it would apply to both, and we have done some thinking about that since some of the staff members raised the question.

I think, pulling back for a moment, the instance of the filing of involuntary bankruptcies against any significant business in this Nation today, is almost nil, because the risks attendant upon it, for someone who would seek to put the likes of an Eastern into involuntary bankruptcy are simply enormous, and it has not been done, and I rather suspect it would not be done.

I think the problem with trying to——

The CHAIRMAN. Let me stop you there. Assume that is the case. Should we be considering this in terms of the size and scope of the corporation, and the assets that a corporation must have in order for this to apply? Because we both can think of—I can think of situations, at least—I may be wrong—where the bill could be used as a club in an involuntary context, where there is a smaller outfit that is owned by a larger outfit, a smaller outfit that is in fact susceptible to several, and only several creditors, where a single creditor would conclude that it is a useful vehicle to force that outfit into bankruptcy to get to assets of the larger entity. So have you thought about——

Mr. SIMON. Again, we have, to this extent. We are dealing in a discrete industry context, and the airline industry does not really have the kind of "mom and pop" situations that I think are contemplated by your question.

I rather suspect that if the judgment of the committee was that there should be some threshold amendment to it, so that it would apply only to air carriers of some significant size, that is something that we ought to look to see, empirically, whether there is a basis for it.

My inclination is to say that—and it is one of the reasons, candidly, that I think it is industry-specific—is that there are unique characteristics in the air carrier business, and those unique interests may override, and, in our judgment, do override the kinds of risks you have identified.

I think those risks are there, I think there is some potential for mischief in the event of involuntary bankruptcies in the abstract.

I think, however, in the particular industry we are talking about——

The CHAIRMAN. And you say because we are only talking about the airline industry——

Mr. SIMON. That is correct.

The CHAIRMAN. That that——

Mr. SIMON. I think your question would raise significant problems if it were industry-wide.

The CHAIRMAN. Not industry-wide but——

Mr. SIMON. Multi, across industry.

The CHAIRMAN. Across industry?

Mr. SIMON. Yes. American economy-wide.

Senator METZENBAUM. If I could just interject. Professor Eisenberg is going to testify later in this hearing. He addresses himself to this question of involuntary as against voluntary, and actually suggests some change in the legislation on that point, and I would just make that observation.

The CHAIRMAN. Good. I was not sure it should be. I just wanted to know what your view was. As I said, I truly have an open mind about this legislation. I have real concerns about some of it, and I see some real strong points to some of it, and that is what I am attempting to find out here.

Now, Mr. President, a question for you, and either I owe you an apology, or, you are even as smart as I thought you were because I notice you are wearing a shamrock, now, below the Lorenzo pin.

Mr. WINPISINGER. No. I am as stupid as you indicated I was, Senator, but the staff is always on the ball.

The CHAIRMAN. And let me ask, since I was late—I am told that the two questions I had for you have in fact already been asked, and I will read the record to get the answers to them.

But I would like to ask your attorney one question and then I will yield back to the Chair.

As I understand it—and correct me if I am mistaken—the formula for getting at the assets of a parent corporation that the Senator from Ohio has employed here, do mirror, mechanically, if you will, the IRS code as it relates to ERISA.

But I see one gigantic difference. There, I think they suggest that the parent must own somewhere on the order of 80 percent of the assets, and here, the chairman suggests they need only own, or control about 30 percent of the assets. Is that correct?

Mr. GUERRIERI. Yes. That is correct.

The CHAIRMAN. OK. I have no further questions.

Senator METZENBAUM. Thank you very much. I might say to my colleague that some times the realities of the world in which we live have to be considered, and I think that in this situation we find that very situation. Texas Air Corporation controls 30 percent of the U.S. air market, and 34 percent of the voting control of Texas Air, that is, Jet Capital does that, and if you look at this whole conglomeration, I think it explains the problem.

The CHAIRMAN. If my colleague will yield for a moment. I am in no way questioning the authenticity or motivation of it. I just want to make sure the record is clear here that—as I said, I am not sure whether you are right or wrong on it, but it is different in one respect, and in one potentially significant respect. I am not saying it should not be. I wanted to make sure I understand that the difference did exist, if it did exist.

Mr. GUERRIERI. Perhaps, Senator, if I just might add, that in our view, the 30-percent figure really fits the airline industry and its uniqueness, particularly since the advent of deregulation, where this chart here is becoming more typical than not for a whole number of airlines that are beginning to emulate the holding company pattern that Mr. Lorenzo has established.

The CHAIRMAN. With the Chairman's permission, may I ask one more question. To the extent that you would be willing, or able to do this, I would appreciate it.

As I said at the outset, one of my concerns is, quite frankly, Frank Lorenzo. I do not mean he is a "good guy" or a "bad guy."

But one of the concerns I have is, is Mr. Lorenzo spawning a new way of doing and/or perverting—depending on how one views it—American business? And so that is what I meant at the outset.

You just made a statement that Mr. Lorenzo is less the exception than he is beginning to be the rule in the way in which the airline industry is organizing.

To the extent—and my staff will do this on its own, but it would be helpful if you could provide it, and I would ask each panel to come forward, if they know.

To the extent that they can lay out for us—not this morning, but for the record—the corporate structure of the other major airlines in America, it would be a very useful thing for me.

If Mr. Lorenzo is the exception, then I am much less worried—it does not help you all very much—but I am much less worried. If Mr. Lorenzo is the rule, then I am much more concerned.

And so, it would be a useful thing for me to know, and I think hopefully for my colleagues to know, and the Congress to know.

Senator METZENBAUM. Thank you very much, Senator.

The CHAIRMAN. Yes, Mr. Winpisinger?

Mr. WINPISINGER. May I make this point. First of all, take it from me, Senator, these are "bad guys." So much for that. [Laughter.]

The CHAIRMAN. Well, let the record show that that is——

Senator METZENBAUM. An unprejudiced point of view.

The CHAIRMAN. That is a prejudicial statement, which I will accept for the record, at the moment.

Mr. WINPISINGER. I view it to be a factual one. The fact is that in the air transport—I would not want anyone to think—and it has been skirted around a little bit this morning—that this is a proposal, or legislation geared to Eastern Airlines. It simply is not.

It is a problem that has existed and keeps building in the fashion displayed here, and we think will continue to build, and it may be a catalyst, as there almost always is in a situation where Congress legislates. Something crystallizes a problem, and gets it into the "front-burner posture" so that we can go to work on it. This I believe is that kind of a case.

This simply dramatizes what has been going on, what we expect will continue, if it is not headed off, and 30 percent seems to be—well, Mr. Lorenzo gets by with 34 percent of Texas Air, and I have never heard any responsible observer say that he does not have absolute control.

He runs it, pure and simple.

And that seems to be characteristic, as counsel said, about the industry in general. If you have a 30-percent connection, or more, you are pretty well able to run the sibling.

The CHAIRMAN. Well, you have answered my question. I appreciate it very much.

Senator METZENBAUM. Captain Duffy, one very short question which obviously I think I know the answer to, but I want to be certain.

Mr. Winpisinger has said that if there were a board appointed the Machinists would be prepared to go back to work under the presently existing terms, that is, the terms that existed prior to the bankruptcy being filed.

He has also indicated that they would go back to work if there were binding arbitration.

Am I correct in my assumption that if they went back to work the pilots would go back to work as well?

Captain DUFFY. That is correct, Mr. Chairman. We are in a sympathy strike with the Machinists, and if the Machinists go back, we will go back.

Senator METZENBAUM. Thank you very much.

Gentlemen, thank you very much. Oh, I am sorry. Senator Specter. I apologize. Senator Specter, I do not know if you have any questions for these gentlemen.

Senator SPECTER. Yes. Thank you, Mr. Chairman.

I would like to pursue the line of inquiry as to what the impact will be on corporate law generally, aside from the context of this specific case.

At the outset, let me note that the record already shows that I joined colleagues in the Senate in a "Dear Colleague" letter urging President Bush to bring up the Mediation Service.

I have already taken some action to try to use the governmental facilities to mediate this dispute, and to delay its impact. But when I listened to the proposals—and they are complicated, and I do not know all the ramifications of them—I have grave doubts about modifying corporation law, and holding companies, in response to a specific problem in the midst of the heat of the problem.

Customarily, legislation is crafted when we are in a state of calm, quiescence, and we look at a matter in terms of principle to decide what ought to be done, without a specific legislative response to a specific problem. Sometimes we legislate on a specific problem, but that poses a certain danger signal.

The Constitution has a provision about a bill of attainder. It is not close to this, but it is somewhat similar in that you try to legislate for a specific individual or a specific point.

That is a criminal matter, so it is very different, but there is a cautionary signal that goes up to me. The instance of ERISA has been mentioned in Senator Biden's questioning with respect to the 80 percent shareholder, or control interest.

Is there any other precedent for piercing the corporate veil, or making parents or holding companies responsible for the debts of the subsidiaries, aside from the ERISA analogy?

Mr. SIMON. Well, you do have the whole concept in the common law of alter ego, or piercing the corporate veil in the context of commercial transactions. In bankruptcy you have the notion of consolidation of the cases, substantive consolidation.

Our view is that those instances take place on a case by case basis with a total lack of uniformity, both in the courts that apply them, and with respect to the articulation of the standards they apply. So we think there is a very real value to Congress setting forth the rules, so that everyone will know what they are in a bankruptcy court in the Southern District of New York, or in San Diego, CA.

Senator SPECTER. Well, Mr. Simon, I do not agree with you about the lack of a standard. There is a very expansive body of case law as to what constitutes the procedure for piercing the corporate veil.

You have fraud, you have very carefully delineated circumstances for doing that, and it is a very tough standard to meet.

When you talk about "substantive consolidation," what are you referring to on that?

Mr. SIMON. Well, in the bankruptcy law now, there is—for all intents and purposes I am going to oversimplify—but it is much the same as piercing the corporate veil would be in a nonbankruptcy context, is when the bankruptcy court will reach through the corporate structure and pull down into one case a parent, subsidiaries, sibling corporations, for purposes of reaching assets for distribution among various creditor classes.

Senator SPECTER. When you talk about ERISA, and looking to a parent's assets in that context, that is an area where there has been a very solid declaration by Congress of public policy to protect pension benefits, and an 80-percent threshold is a very different threshold than 30 percent. If you talk about what may constitute control, you can have effective control, in a corporate context, with 10 percent. You may even have it with 8 percent, or with a great deal less.

So that where you come to such a very fundamental change on corporate structure, it seems to me that we have to take a very careful look at it, and see if it is principled, if it is something that can be applied otherwise.

What is to stop other industries from coming in and making the same claim? Why are the airline so unique as to call for a very major change in corporate law in this country?

Mr. SIMON. Well, I think if you look at it not as a change in corporate law in general, but a change in the bankruptcy law specifically, and you take into account what has been said earlier today, and I think what instinctually we appreciate—which is that there is something very special about the airline industry because there is something very special about getting into a cockpit if you are a captain, or getting into a passenger seat if you are a passenger, and wondering about whether you are going to emerge safely on the other end of the trip.

So I think there is something very unique and very distinct about air transportation, which has been reflected by the Congress in a whole variety of instances, the Railway Labor Act not unique among them.

So I think there is something very industry-specific to this, and I would expect the Congress, as it will doubtless do with respect to this bill, to give any other industry that comes forward the same kind of careful scrutiny we would expect this bill to receive.

I think you are quite correct in saying that this is something that should be approached only after careful study and only after a case has adequately been made, that in a bankruptcy context, and in the airline industry-specific context, this is an appropriate measure.

I think the use of the control standard for the code should make it somewhat easier for Congress to approach the concept of whether there should be a control group.

Candor requires that one has to justify the use of a 30 percent as opposed to an 80-percent standard, but if you put aside the quantification question, and just focus on whether or not—however you define control—those entities that are commonly controlled should be commonly responsible.

I would suggest there is very little, intellectually, that one can distinguish between pension obligations, the ultimate liability of the Pension Benefit Guarantee Corporation, and the kinds of issues we are talking here with respect to other creditors.

Pensions are surely significant. The U.S. Government, in its liability under the Pension Benefit Guarantee Corporation is surely significant. But I think that precedent points to the fact that other creditors ought perhaps also to have the same level of protection and access to the same bundle of assets, as would, for example, the PBGC.

The 30 percent as opposed to 80 percent, I acknowledge is a more difficult bridge to cross. We suggest, and we think the evidence empirically will support it, that the 80 percent notion—which is really a throwback to the old tax reorganizations that I remember learning about in law school in the 1950's—does not really bear any relationship to the real world of corporate control today.

And I think that if you ask an investment banker, if you go to the street, and you look to what is required for effective corporate control today, 80 percent is simply antediluvian. I mean, it goes back to an earlier era of corporate structure.

In the real world of here and now, and today, merger and acquisition, and the corporate superstructures, 30 percent is really what "control" means.

Senator SPECTER. Well, all of that, it seems to me, is besides the point on making such a revolutionary change in the corporate law which has been in effect for centuries, in terms of restructuring the liability of parents or of holding companies. Now maybe that ought to be done. Maybe the insulation of the corporation has outlived its usefulness, but corporation law is basically a creature of state.

It has come to us from the common law. Corporations are governed by the laws of the 50 States. Parent and subsidiary responsibilities are controlled principally as a matter of State law. Of course we have Federal bankruptcy laws.

But what is being suggested here would have just enormous, enormous ramifications in the business structure everywhere in this country.

Mr. SIMON. If I may respond without repeating——

Senator METZENBAUM. Respond, briefly. There are other witnesses, and I do want to proceed. I do not mean to cut Senator Specter off at all, but we are trying to follow a 10-minute rule. But if you could respond, briefly.

Mr. SIMON. In one sentence.

Senator SPECTER. Is my time up, Mr. Chairman?

Senator METZENBAUM. Yes, but, you know, I do not want to cut you off if you have another question.

Mr. SIMON. [a] This is bankruptcy——

Senator SPECTER. In fact he may want to cut you off, though. [Laughter.]

Mr. SIMON. I certainly understand the distinction.

[a] This is bankruptcy, not general commercial law, and bankruptcy is a matter for uniform adoption by the Congress of the United States under the bankruptcy code. [b] It is not American industry-wide. It is airline industry-specific. And [c] we believe the case can be made that for this industry, in this context of bankruptcy, the proposal that is made is really a minimalist approach to making available to all creditors, on a fair and equitable basis, the assets that an airline company uses to provide service to the public.

Senator SPECTER. Well, Mr. Chairman, I understand the time constraints, and I shall not pursue this question now. Suffice it to say that it is a very complicated question, has enormous ramifications, and is not something we can decide with one witness and not something we can decide on one foot.

So I will think about it.

Senator METZENBAUM. Thank you very much.

I should point out to my colleague from Pennsylvania, that I had earlier told Senator Biden, that Professor Eisenberg of Cornell is going to address this entire subject later.

He does point out—and I am reading from a very short item he has—"It is worth noting that the bankruptcy law treats corporations as affiliates if they are only 20 percent common ownership." And he quotes the statute, 11 U.S.C. 1012. "Affiliate status subjects corporations receiving preferences to a more stringent set of rules than those applicable to nonaffiliates," and he has a citation for that.

So he will be discussing that matter. But thank you very much, gentlemen.

Senator THURMOND. Mr. Chairman, Senator Hatch has sent a statement, and I would ask unanimous consent that it go in the record. I would just call attention to two points he makes. He says, "I urge that the record of hearing be left open for a considerable period of time."

The next point is: "It is imperative that we have an opportunity to obtain as much input as possible from additional experts and interested parties."

I would just ask it be put in the record.

Senator METZENBAUM. Without objection, Senator Hatch's statement will be included in the record, and the record will remain open for one week

I want to say, at this point, that I heard from Mr. Lorenzo the earlier part of the week. I spoke with Mr. Lorenzo and invited him to join us here today.

He indicated that he did not feel that he would be able to do so, and I must say that I am indeed sorry that he was not able to accept the committee's invitation because I think that no matter how you slice it, Mr. Lorenzo, in many respects, can give us answers that nobody else is capable of doing.

Now before we hear testimony from our next witness, I want to note, for the record, that in addition to Texas Air, the committee invited other representatives of the airline industry to testify.

We asked both Eastern Airlines and the leading trade association for the airline industry, the Air Transport Association. Both Eastern and the ATA declined our invitation to testify.

The hearing record will remain open for 1 week for the submission of written statements. I invite all interested parties, including representatives from the airline industry and from the creditor community, to submit written statements for the record.

At this point we will hear from the representative of Texas Air, but I want to note, for the record, that this committee received Texas Air's testimony, and only one copy, at that, at 5 minutes after 12:00 last night.

I realize this hearing was put together under tight deadlines. Nonetheless, every other witness managed to provide copies of their testimony in advance.

Texas Air is a very large company, and given the resources that it has at its disposal, frankly, this committee is very disappointed that they saw fit to give us their testimony after midnight last night.

It makes it that much more difficult to ask questions concerning that particular testimony. I must say that this is not a new rule around here. Texas Air is well represented in the Washington arena, and they know that committees normally want their testimony at least 48 hours before the committee hearing takes place, and I feel that there may be a kind of an impertinence in their failure to make it available to us until after midnight.

Having said that, we will be very happy to hear from Mr. Elliott Seiden, Associate General Counsel of Texas Air Corporation, accompanied by Harvey Miller of Weil, Gotshal and Manges of New York.

Mr. Seiden, we want to be fair to you. The committee normally has a 5-minute rule. I do not want to use a 5-minute rule in connection with your testimony. How much time do you think is reasonable?

Mr. SEIDEN. Seven minutes I think would do it, Senator.

Senator METZENBAUM. Pardon?

Mr. SEIDEN. About 7 minutes for my oral presentation ought to cover it.

Senator METZENBAUM. No problem. Please proceed.

STATEMENT OF A PANEL CONSISTING OF ELLIOTT M. SEIDEN, ASSOCIATE GENERAL COUNSEL, TEXAS AIR CORP., WASHINGTON, DC, ACCOMPANIED BY HARVEY MILLER, OF WEIL, GOTSHAL & MANGES, NEW YORK, NY

Mr. SEIDEN. Thank you. Good morning, Senator, Mr. Chairman. First, I would like to apologize to the committee to the extent we put the committee to any inconvenience by the lateness with which we submitted the statement.

It was done as rapidly as we possibly could. We were under quite a bit of pressure to get it done, and we just did the best we could.

Mr. Chairman, accompanying me is Harvey Miller. Harvey Miller is an expert in bankruptcy law. He is an adjunct professor of bankruptcy at New York University. He is a contributing editor to Collier's on bankruptcy, and he is of course Eastern Airlines bankruptcy counsel in the matter that was filed last week.

Any matters that address specific and technical issues having to do with bankruptcy I will be deferring to Mr. Miller, with your permission.

Mr. Chairman, in our view, S. 544 is a bad piece of legislation. It will jeopardize Eastern 's ability to reorganize. It will needlessly throw another airline into bankruptcy. It will undermine the ability of the whole airline industry to obtain much-needed financing.

It will, as a result of the previous two effects that I have just identified, undermine competition in the airline industry in a very significant way.

And finally, it presents grave questions of constitutionality due to its retroactive application to Eastern, Continental, and Texas Air.

S. 544 will have a pernicious and draconian effect on Eastern Airlines. After 9 years of an unrelenting smear campaign against whomever happened to occupy the executive suite at Eastern Airlines—Charlie Bryan called Frank Borman, an American hero, in my judgment, a Nazi, in 1980, no less than 12 days after Mr. Bryan became president of District 100—Eastern has been forced into Chapter 11 by the refusal of its pilots to come to work. Up until March 9, Eastern placed all hope on the expectation that, in the end, reason would prevail.

Its management earnestly believed that Eastern 's unions would have a stronger urge to preserve the company and their jobs than to preserve their campaign to vilify Eastern's senior management.

We have been proved wrong on this, and so we must now put all of our hope in the impartial reconstructive procedures of the bankruptcy court.

Eastern's primary and only goal is to emerge from chapter 11 as an operating airline, and to make all of its creditors whole. S. 544 places in severe jeopardy any prospect that this ever can happen.

By forcing Continental Airlines and Texas Air Corporation to join Eastern in Chapter 11, and subjecting Eastern's assets to the demands of the creditors of these and other affiliates, Eastern's assets will be exposed to claims by creditors that may exceed Eastern's ability to pay.

Moreover, Continental's future will be placed under a severe threat, as Chapter 11 status for an airline causes massive losses of traffic and bookings by the mere fact of the filing of the petition.

There is no certainty that Continental could emerge from bankruptcy successfully. Indeed, the prospects for a successful reorganization at both Continental and Eastern would be severely prejudiced by the fact that Texas Air, by virtue of this legislation, if it becomes law, also would be in bankruptcy, and probably unable to assist either company with financing and cash advances of the type that carried Continental through its previous highly successful reorganization.

The failure of another airline, coming on the heels of the Eastern shutdown, would effectively remove from the market in the United States approximately 16 percent of all domestic airline capacity.

With such a sudden contraction of capacity millions of passengers would be unable to travel at all, and those who are lucky enough to find an empty seat would pay grossly inflated fares as the remaining airlines would use higher prices to regulate excess demand.

This bill will destroy competition in the airline industry, not only because of the demise of Continental and Eastern. It will also cause a major contraction, as I have indicated.

But the bill also will undermine, in a very critical and central way, the ability of airlines, a unique industry, to obtain financing anywhere on competitive terms.

In the future, if this bill becomes law, Mr. Chairman, no corporation would, or could consider acquiring a troubled airline, since if the airline were to fail after the acquisition, the buyer and all of its affiliates would be thrown into bankruptcy with that airline.

For similar reasons, Mr. Chairman, no clear-thinking businessman would venture to build a new airline within the existing corporate family that he was in. The risk simply would be too great to the rest of the enterprise.

All airlines suddenly will find the cost of capital to be exorbitant, because a prudent lender to an airline will have to undertake a complete credit evaluation of all of the borrower's affiliates, and further, will have to require adequate guarantees and security from all affiliates to protect its position.

This procedure would raise transaction costs substantially to lenders, and would tie up assets, needlessly, that might be used for other purposes.

In essence, this bill turns airlines into financial viruses that infect all family members with whom they are affiliated. The only way to inoculate the other affiliates of an airline after this bill were to become law—if it were to happen—would be to spin off the airline property and leave it out there by itself.

But this cure would be very damaging to that airline because it would deprive it of the many financing and other holding company efficiencies that have led all but one of the domestic airlines to opt for the holding company structure.

The airline industry——

The **Chairman**. Could you tell me which airline that is.

Mr. **Seiden**. Delta.

The **Chairman**. Delta. Thank you.

Mr. **Seiden**. The airline industry's substantial need for capital to re-equip would be placed in jeopardy. If troubled carriers like Pan American World Airways, for example, have any hope to survive through acquisition, I believe S. 544 dashes that hope.

One of the most dangerous and unfair features of the bill is its retroactive applicability to Eastern and Texas Air.

On March 9, 1989, Eastern was presented with the most difficult and momentous decision in its proud 60-year history. It would be manifestly unjust, and we believe unconstitutional, to deny Eastern the right to make the decision whether to seek Chapter 11 protection, without affording Eastern advance notice of what the financial consequences of that decision would be.

Relying on existing law, Eastern weighed all its options and made its difficult decision. If Eastern was not entitled to rely on existing law on this occasion, then it was totally deprived of its ability to make an informed and responsible judgment on this matter of monumental importance to the company, its employees, its stockholders and its creditors.

The fact is S. 544 was not the law of the land on March 9, it is not the law of the land today, and it may never be the law of the land.

For the reasons contained in my prepared statement, Mr. Chairman, we respectfully submit that S. 544 should not be voted out of this committee.

Thank you.

[The prepared statement and response to questions follow:]

STATEMENT
OF
ELLIOTT M. SEIDEN
ASSOCIATE GENERAL COUNSEL
TEXAS AIR CORPORATION

BEFORE THE
SENATE JUDICIARY COMMITTEE
REGARDING S. 544

March 17, 1989

STATEMENT OF ELLIOTT M. SEIDEN

Introduction

Mr. Chairman, Members of the Committee:

My name is Elliott M. Seiden. I very much appreciate this opportunity to address the Committee on behalf of Texas Air and its subsidiaries in connection with S. 544.

I am Associate General Counsel for Texas Air Corporation, based in Texas Air's Washington office. I have been with the company for little over three years. Prior to joining Texas Air, I was an attorney with the Antitrust Division of the U.S. Department of Justice. From 1978 until 1985, I was Chief of the Transportation, Energy and Agriculture Section in the Antitrust Division. I have seen deregulation from both sides, and I am no less an advocate of deregulation now, in spite of the turmoil it sometimes inflicts on consumers, employees, and yes, management of our airlines, than I was when I supervised the Justice Department's legislative and regulatory efforts to bring about the 1978 Deregulation Statute.

In the last three years, I have also had the opportunity to observe at close hand, and to participate in, many of the critical decisions made at Texas Air. I was closely involved in the effort by Texas Air to purchase Eastern, and I have worked personally with Mr. Lorenzo and his management team on this and other central Texas Air projects. I make these personal observations, because I wish to affirm to this Committee my own personal conviction that from the very beginning, until March 9, 1989, the unwaivering intent of Texas

Air's management was to fix Eastern's problems, which had been festering for fifteen years, and to restore it to its great and historic position as one of the original four trunk carriers.

In recent months, all eyes have been focused on Eastern's labor problem. This, of course, is a very serious problem, but it was far from the only problem. Eastern had a reliability problem. Under Texas Air's stewardship, hundreds of millions of dollars were spent on maintenance to improve reliability, with the result that in the last four months, Eastern led all U.S. carriers -- even the self-proclaimed on-time machine -- in on time performance. Eastern worked to expand the computer penetration of travel agencies, and it was successful in this objective as well.

Eastern worked hard to complete its South American route network. I worked on this project personally. When Texas Air closed the Eastern acquisition in November, 1986, there were three critical missing pieces from that network: Peru, Venezuela and Brazil. Today, Eastern serves Peru and Venezuela, and recently succeeded in obtaining landing rights to Brazil.

I can tell this Committee, without mental reservation, that the last thing anyone at Texas Air wanted to see was the Chapter 11 filing that Eastern was forced to make last week. Mr. Lorenzo transmitted a video tape to each Eastern employee explaining the offer that Eastern had made to its pilots. Eastern believed that its offer met all of the pilots demands, particularly for job security and asset preservation. The pilots rejected Eastern's offer. Eastern made two major concessions to the IAM in the waning days of the "cooling off" period. Both offers were rejected. Before filing its Chapter 11 petition, Eastern sought an injunction in federal district court that would have ordered its pilots back to work. As Eastern advised the Court, an injunction was Eastern's only and last hope of avoiding bankruptcy, which it desperately wished to avoid. Eastern was unable to obtain the injunction. (A federal appeals court sitting in Atlanta will review this district court ruling on a highly expedited schedule, next Thursday.) Thus, when Eastern filed its petition with the Bankruptcy Court, it truly had nowhere else to turn. It did what it had to do, not what it wanted to do.

Now that Eastern has finally if reluctantly sought protection from its creditors, its only hope of restoring itself to viability as a going concern is to achieve a successful reorganisation under Chapter 11 of the Bankruptcy Code. The Bill now before this Committee, S. 544, would have immediate, severe implications for the ability of Eastern Air Lines to achieve this goal. Furthermore, the Bill has dangerous, far-reaching implications for the competitive structure of the airline industry.

S. 544 would dramatically lower the threshold for involving parent companies and other corporate relatives in an air carrier subsidiary's bankruptcy. Contrary to long-standing notions of limited liability corporations in United States trade and commerce, this Bill would trample on the separate corporate structures that have been established in the airline industry generally, and at Texas Air in particular. It would require financially healthy companies to file for bankruptcy merely because they hold a minority interest in a financially troubled airline. In the future, no corporation could or would consider acquiring a troubled airline, or starting a new airline, be it a regional, commuter or national airline, because the risk of failing could not be confined to the new venture itself. If this Bill becomes law, the failure of a new venture will force the parent into an unnecessary and damaging reorganisation of its own assets and businesses.

The Bill would expose the creditors and pensioners of Eastern to liabilities and difficulties they now do not face. If this Bill becomes law, creditors of Continental and Texas Air, both of whom would be thrown involuntarily into bankruptcy, would be able to call upon Eastern's assets to satisfy their loans. In addition, pensioners at Eastern who now under ERISA can look to a solvent Continental and Texas Air for satisfaction of Eastern's pension obligations, should Eastern be unable to fund these obligations fully itself, would be left to look to two companies in bankruptcy. The extent to which Eastern pensioners could seek satisfaction from Continental and Texas Air in these circumstances would depend upon the decision of the Bankruptcy Court. In any event, these two companies would be weakened by the very fact of being in bankruptcy, and therefore less capable of meeting whatever obligations the Judge might authorize.

The Bill also would eliminate an air carrier's ability to modify its collective bargaining agreements, even if such modifications were indispensable to a successful reorganization. The Bill conflicts directly with recent congressional action establishing Section 1113 of the Bankruptcy Code, which section delineates carefully the circumstances under which a bankruptcy judge may allow modifications of collective bargaining agreements.

Finally, the retroactive application of the legislation to Eastern and its affiliates is both unconstitutional and unjust.

Background

The historical background of Eastern and the events which led to the commencement of its chapter 11 case have been well publicized. Unfortunately, the facts have been thoroughly ignored by those who see Eastern's travail as an opportunity to advance goals having nothing to do with the survival of Eastern, the jobs of its 30,000 employees, and the critical competition that Eastern has provided in its markets. Since the big lie strategy depends not only on the repeated distortion of central facts, but also on the anticipated silence of those who know better, I request that the Committee permit me to state what really has been happening at Eastern in the last several years.

The strongest human emotion is hate. Realizing this, the union leadership understood quite well that if they could instill strong feelings of hate in the rank and file for Eastern's management, they could shift the focus of the debate from Eastern's real economic needs to a personal battle of good against evil. They have been remarkably successful in this strategy.

In fact, the unions' campaign of vilification against Eastern's management began long before Texas Air arrived on the scene. Mr. Bryan, President of Eastern's IAM local, constantly accused Eastern's former management, and particularly its Chief Executive Officer, Frank Borman, of lies and deceit, of brutalizing employees and of intentionally failing to earn a profit (according to Mr. Bryan so as to have an excuse to reduce employees's salaries). To see how dramatically attitudes can change when leadership changes, it is instructive to compare the following January 16, 1980 statement from Mr. Bryan's predecessor as local union President (Mr. Jim Cates) when Mr. Cates left office:

> Mr. Frank Borman, whom I have the utmost respect for, was the company official, in my opinion, that did the most for Eastern in the 31 years I have had an employee-employer relationship. Mr. Borman, I'm sure, will continue to work with the leaders of the District for the interests of all.

with the following statement made by Mr. Bryan just 12 days later:

> We continue to act in a professional and responsible manner in spite of the fact that [Eastern] has resorted to illegal gangsterism in their labor relations policy.
>
> * * *
>
> The gestapo tactics of Martin Ludwig Borman and his 'Nazi Torched Earth Policy' will not work with this union leadership.

Colonel Borman is an American hero. He is a good and decent man. To compare him to one of the worst villains who ever walked the face of the earth is utterly repugnant and beyond the bounds of civilized discourse and behavior. These are the kinds of people Eastern's management has had to deal with over the last nine tortuous years. As incendiary and obnoxious as this rhetoric was, it reached new levels of fury and inhumanity after the Texas Air acquisition. Now, Mr. Lorenzo was being described in one of ALPA's publications as a "follower and admirer of several historical figures, Adolph Hitler, Joseph Stalin and . . . commandants [in] North Korea , China and North Vietnam."

The unions' campaign of vilification and character assassination was not restricted to whomever happened to be at the helm of Eastern Air Lines, however. It was also directed at the company itself, with a concerted campaign to frighten the travelling public into believing that Eastern was unsafe. To quote just a few of the comments of the IAM and ALPA, Eastern is a company "shaving on the margin of safety and something is going to happen"; "limp[ing] along in the razor thin edge of safety"; with "safety margins shrink[ing] on a daily basis"; managed by "bloodthirsty cost cutters" who "are going to kill somebody before the message gets through", abusing employees so that they committed suicide and were so distracted that they crashed their private planes; on the ragged edge right now of having some enormous number of tragedies".

All of these charges -- and many more that have been made by the unions -- are grotesquely false. Since the Texas Air acquisition, Eastern has increased substantially its spending on aircraft maintenance so that in 1987, Eastern spent more on aircraft maintenance, on a per unit basis and as a percentage of operating expenses, than any other major U.S. airline.

Simultaneously with trying to convince the public not to fly Eastern, the unions were ensuring that those who did fly would regret it. Specifically, ALPA engineered a massive slow down -- the infamous "Max Safety" campaign. Although the effort was characterized as a safety campaign, it was, in fact, an economic weapon against the Company. This is obvious from ALPA's own literature (some of which encourages the use of a "safety campaign as an economic weapon against the Company"); from the campaign itself which, for example, as part of its "safety tip of the week" approach urged pilots to write up reports for items that were in short supply and from various witnesses, one of whom (a pilot at Eastern) testified that he had personally been asked by the head of the ALPA local union at Eastern to conduct a "range war" against the Company in the form of a safety campaign.

The Max Safety campaign had several aspects:

- increased "write ups" of aircraft, especially write ups for equipment in short supply, leading to flight delays (while the allegedly needed maintenance was performed); or cancellations (if the needed replacement parts were not available).
- various disruption tactics while in the cockpit, such as the instructions to "slow taxi" ("safety" tip #23), to burn more fuel ("safety" tip #29), to use only full instrument approaches ("safety" tip #61), to delay take-offs ("safety" tip #28), and to write up the presence of any insect on the aircraft so that the aircraft would be grounded until fumigated ("safety" tip #71).
- the refusal of pilots to accept aircraft that were, in fact, airworthy, thereby causing flight delays or cancellations if no substitute aircraft were available. In one particularly egregious example, one pilot refused seven aircraft in a single month.
- a postcard campaign where pilots were instructed to send in postcards to the FAA notifying it of safety violations at Eastern. The FAA later announced that of 1300 such cards, only six appeared to warrant even further investigation.

All of this was intended to, and did have a significant impact on Eastern's operating performance, reputation and revenues. Indeed, in October 1987, Jack Bavis, the head of the ALPA union at Eastern, sought further funding from ALPA National to carry out the local union's "attack" against the Company and actually bragged about how effective the campaign had been:

> There can be no doubt that the money spent by the pilot group to engage in these . . . efforts cost Texas air Corporation many times that amount in lost passenger revenues, employee concessions not realized, and money spent for damage control to counteract the notable successes of the Eastern MEC in Congress, the media, and among the pilot group as well.

* * *

> With due modesty, we feel we have helped blacken Lorenzo's eye so that other managements will not be so quick to emulate his apparent success. We have helped cause him trouble at both Eastern and Continental and hurt him in his dry heart -- his pocketbook."

Mr. William Winpisinger, President of the national IAM expressed a similar sentiment. In an April 21, 1988 article in the Atlanta Journal, he was quoted as stating that he was not disturbed by the prospect of an Eastern bankruptcy:

> [I]f I can wake up in the morning and think of another thorn I can stick in [Eastern's] lousy side, I'll do it . . . You haven't seen half the things we're planning to do. My job is to marshal all of our resources to fight.

As to bankruptcy, Mr. Winpisinger stated that he would use it as an opportunity to attempt to buy the company.

All of this turmoil climaxed in Department of Transportation and Federal Aviation Administration investigations of Eastern's fitness and safety. The DOT investigation found Eastern fit and the FAA investigation found Eastern safe (although noting that an unprecedented degree of labor-management hostility could cause future safety problems). The FAA inspected each aircraft in Eastern's fleet at least once (and most were inspected several times) during the month and one-half the investigation lasted. This investigation severely disrupted Eastern's operations and caused further severe damage. Not only was the Company's commitment to safety again questioned in this most extraordinary manner but also the operational difficulties occasioned by the FAA ramp investigation inconvenienced thousands of passengers.

No company can prosper in this kind of poisonous atmosphere, and Eastern paid for it dearly in 1988, when it suffered a net loss before capital gains and sale of tax credits of $462 million. As one example of the direct negative impact the turmoil at Eastern has had on its revenue base, in the first nine months of 1987, Eastern had a share premium (the difference between its share of industry revenue passenger miles and its share of industry capacity) of 0.5 percentage points; for the first nine months of 1988, the premium had disappeared. This seemingly small decrease is worth $195 million annually. Due to the determined efforts of Eastern's unions, higher paying business travelers stayed off Eastern flights as much as they could, because Eastern's own employees made Eastern a risky choice to get there on time.

And while the magnitude of the loss suffered in 1988 is staggering, it is hardly out of keeping with Eastern's experience in the decade since deregulation. Since January 1, 1980, Eastern has lost over $1.5 billion before gains from the sales of assets and tax benefits. During this period, Eastern had net losses of over $1 billion, while the remainder of the industry had a net income of approximately $2 billion.

The substantial profits earned by the rest of the industry, while Eastern has been suffering enormous losses, have allowed other companies to make significant expansions into Eastern's markets. The increased competition resulting from such expansion has greatly exacerbated Eastern's financial problems.

Eastern's losses have been largely funded by debt financing. As of September 30, 1988, Eastern's debt and capitalized lease obligations totalled approximately $2.5 billion; its annual debt service was approximately $560 million in 1987 and approximately $575 million in 1988.

The Company's debt expense has imposed a severe drain on Eastern's revenue and has restricted the Company's ability to commit capital to the improvement of the airline. Eastern's ability to use its resources for product enhancement has been further hampered by the Company's labor costs, which, as a percentage of its revenues, have always been among the highest in the industry. Thus, Eastern's combination of interest expense and labor costs, as a percentage of operating revenue, is the highest in the industry. While other airlines have been able to apply revenue to expansion projects, such as the acquisition of additional aircraft and facilities, Eastern has been required to apply its revenues primarily to servicing debt obligations and meeting labor costs. Similarly, other companies are able to borrow money to expand -- increasingly into Eastern's markets -- whereas Eastern must use the proceeds of any financing just to stay in business.

The unions have contended that Eastern's problems are due in large part to asset sales which, according to them, have caused an increase in unit costs as fixed overhead has been spread over a smaller operation. They have ignored the fact that without the asset sales, the Company would already have run out of money. Eastern has behaved no differently than other distressed airlines who, when faced with losses that threatened their existence had to resort to asset sales to stay alive.

Thus, before its demise into bankruptcy, Braniff was forced to sell its entire South American division -- ironically to Eastern. It also sold much of its strategic gate position at Dallas/Fort Worth Airport to American. Similarly, to fend off bankruptcy, Pan American has sold its Pacific Division, its only consistently profitable operation, for $750 million to United. Pan Am also has had to sell the Pan Am building, and its Intercontinental Hotel chain. Before it went bankrupt, Frontier sold almost half its fleet to United to avoid insolvency in 1984.

As for Eastern's asset sales and service reductions, all the services dropped were unprofitable, and, partly as a result of union attempts to discredit Eastern, the Company had no promising alternative to which it could put the use of the assets.

Eastern's long-standing, and to date insoluble financial plight required its management to seek pay cuts in order to save the Company from bankruptcy. Indeed, bankruptcy was imminent in 1983 and 1986 -- long before Frank Lorenzo and Texas Air came on the scene.

In 1986, in order to avoid either a bankruptcy, or the sale of the Company, all employee groups, except one, took a 20% pay cut. The exception was the IAM. Since that time, the IAM has received three regularly scheduled raises totalling 8%, so that now, the disparity between IAM-represented employees, created first in 1986, and other Company employees, has expanded to 28%.

Eastern's bargaining with the IAM has concentrated on eliminating this disparity, particularly among the unskilled baggage handlers whose average total compensation was $45,000. Although Eastern proposed substantial pay reductions in this group, it also proposed an historic skills retraining program that would have allowed baggage handlers to be trained at Company expense with full pay for higher paying mechanics jobs. This program could have cost Eastern as much as $100 million.

During the entire 15 month bargaining period, which dragged out beyond reason by virtue of the refusal of the National Mediation Board to recognize a deadlock when such was apparent to any objective observer, the IAM refused to acknowledge Eastern's financial condition, and, in fact, steadfastly insisted that it was entitled to raises. In the final two days of the bargaining Eastern made two major moves, which, considering the Company's financial position and the historic disparity in the IAM's position as compared to all other employees, were extremely generous. It included a 5 year job guarantee and pay increases in the future for the mechanics. The IAM never made a serious counterproposal.

For much of the period that the Company was negotiating with the IAM it also was negotiating with ALPA. The pilot union publicly expressed the goal of achieving job security in those negotiations. Privately, the company consistently provided proposals guaranteeing against pilot furloughs and sale of aircraft. These negotiations became particularly intense in the final weeks before the March 4, 1989 IAM strike deadline. At one time, in fact, the Company was guardedly optimistic that it would reach a settlement with ALPA. Company negotiators believed that they had reached basic agreement over the terms of a "fence" agreement (which contained provisions protecting against furloughs, a reduction in the number of captain positions and disposition of aircraft). Shortly after this point was reached, ALPA changed the composition of its negotiating team; thereafter few meetings were had and those that did occur did not, in Eastern's opinion, elicit any serious proposals by ALPA. In fact, ALPA later reneged on its earlier proposal.

When the IAM struck on March 4, 1989, both ALPA and the TWU (which represents Eastern's flight attendants) joined the strike. ALPA made it completely clear that its action was not motivated by any "sympathy" for the IAM but rather as a means of putting pressure on the Company to achieve ALPA's own economic demands. As such, it constituted an illegal primary strike rather than a sympathy strike.

In starting their strike, the pilots ignored the many pleas of numerous members of Eastern's management and of the Company's non-contract workers. Mr. Lorenzo made a video tape in which he urged the pilots to come to work and to help build what he envisioned as a profitable company. This video was sent to each employee's home.

ALPA's decision to strike is clearly contrary to the economic interests of its Eastern members, and was of course disastrously inconsistent with the interests of Eastern Air Lines, its 30,000 employees, its many communities and thousands of customers. It was the direct and immediate precipitating event for Eastern's Chapter 11 filing. ALPA's financial expert, Farrell Kupersmith, had stated on several occasions that Eastern needed about $200 million of labor cost savings to survive; right before the strike he warned the pilots that a successful strike would probably cause the Company's bankruptcy. As stated previously, in negotiations with the pilots, Eastern offered to provide guarantees against the furlough of pilots or the disposition of aircraft and as to the maintenance of the current number of captain positions. ALPA's stated objection to these protections was that Eastern's parent, Texas Air, would not guarantee their survival in the event of bankruptcy -- in effect, a demand that Texas Air mortgage its future in order to provide guarantees that might prove to be totally unworkable due to events completely outside of Texas Air or Eastern's control. In any event, it makes no sense for the pilots to ensure a disastrous result because Eastern and Texas Air were unable to provide iron-clad guarantees against its happening.

The cumulative effect of all of these events -- work slow downs, publicity campaigns to harm Eastern's safety reputation, cumulative losses of $1.5 billion over ten years, loss of reliability, loss of business travelers, loss of confidence by the travel agents, and finally a disastrous strike by the pilots -- drove Eastern to the door of the bankruptcy court, which it entered reluctantly and with great sadness on March 9, 1989. A successful reorganization under Chapter 11 is now Eastern's highest priority, and Eastern's management is working hard to accomplish this as rapidly as it can. It hopes, and expects that at the end of the day, it will be able to resume normal operations, although on a smaller scale than that operated by Eastern prior to March 9. Eastern, moreover, hopes and expects that it will be able to pay its creditors 100 cents on the dollar at the conclusion of this process. A successful reorganization under Chapter 11 is Eastern's only hope to accomplish these goals.

S. 544 will Destroy Eastern's Ability to Reorganize Successfully, and Further Threatens the Viability of Texas Air and Continental Airlines.

If enacted into law, S. 544 will destroy Eastern's ability to achieve a successful reorganization. It is a bad bill. It is unfair, oppressive, and unconstitutional. It should not be enacted into law.

Simply put, and without exaggeration, S. 544 is a customized piece of proposed legislation in which Congress says to Eastern, its parent, Texas Air Corporation and its affiliates: Eastern is not entitled to use the national Bankruptcy Code and if you try it, Congress will cause the bankruptcy of Texas Air Corporation and its affiliates, including Continental Airlines.

Section 4 of S. 544 first provides that an airline may only be a debtor under Chapter 11 if every member of its controlled group is a debtor under Chapter 11. Therefore, if S. 544 becomes law, either Eastern would have to request the court to dismiss its Chapter 11 case, or Continental Airlines, Inc., Texas Air Corporation, and their affiliates would all have to commence individual Chapter 11 cases.

Dismissal of the Eastern Chapter 11 case, however, is not a result that Eastern can bring about unilaterally, as might be the case in normal civil litigation before a federal district court. Here, Eastern will need the permission of the bankruptcy judge, who will take into careful consideration the interests of all interested parties, including, of course, the creditors. Some, if not all creditors, are likely to object to dismissal because that would result in chaos among competing creditors, as they race to the courthouse to grab assets before other creditors could reach them. This would undoubtedly result in dismemberment of Eastern's assets and properties, precluding any possibility of a successful reorganization. Since no one creditor would know a priori how he would fare in the race to seize Eastern's assets, many can be expected to object strenuously to any proposed dismissal. These types of arguments by creditors frequently are persuasive, and successful dismissal motions of Chapter 11 petitions are rare. It is doubtful, therefore, that Eastern would have the dismissal option available. And if Eastern could achieve dismissal, it would mean the certain, immediate and chaotic demise of Eastern as airline operator.

The only other alternative under S. 544 is to have Texas Air and each of its affiliates daclare bankruptcy, whether or not they are in financial distress. Coercing going concerns to undergo the tremendous trauma, enormous expense and uncertainties of chapter 11 is punishment without cause. The unstated rationale for S. 544 seems to be "we're mad as hell at Frank Lorenzo, and we're not taking it anymore." If providing angry unions with retribution against Texas Air, Frank Lorenzo, Continental, its 32,000 employees and the many communities they serve constitutes a positive result, than S. 544 is right on the mark.

This proposed legislation, however, severely jeopardizes the public stockholders, employees, creditors and investors in Texas Air Corporation, Continental Airlines, and their affiliates. It would impose severe economic hardship on Continental, and could be fatal. The airline industry is a consumer service industry; it runs on trust that services paid for today will be delivered in the future. Chapter 11 status undermines the trust that consumers require to make advance bookings, so the mere filing of a Chapter 11 petition by Continental, as would be mandated by this legislation, would almost certainly cause Continental's bookings to drop, at least for a time, until confidence were restored.

At the same time Continental's bookings were falling off, Continental would be squeezed for cash from its suppliers and vendors, who tend to put companies in chapter 11 on a cash basis, and further tend to accelerate demands for payment. Continental would have no way to meet these demands with financings, since all debt and capital markets would be closed to a Chapter 11 Continental. Nor would Texas Air be able to help out, since it, too, would be in bankruptcy, unable to raise cash, and possibly not even permitted to make advances to Continental to help it out of its cash crunch. The bankruptcy judge would have to approve all such advances. Quite simply, this legislation could mean the demise of Continental Airlines, and produce a dramatic increase in industry concentration that inevitably would mean enormous fare increases for millions of consumers, and the inability of millions more to travel at all. The many unfortunate dislocations that have been inflicted on the public by Eastern's bankruptcy would be inflicted yet again, merely for the sake of satisfying the blood lust of angry union leaders.

While this legislation could well destroy Continental and Texas Air, it will impose enormous hardship on Eastern as well, and possibly jeopardize the rights of Eastern debtholders. With Texas Air solvent, and not under the jurisdiction of the court, it is in a position, if circumstances warrant, to assist Eastern in its effort to emerge from bankruptcy as a revitalized and healthy company.

When Continental was in chapter 11, it added to its fleet approximately 55 brand new Boeing 737-300 aircraft that had been purchased by Texas Air and leased to Continental, in conformity with the Bankruptcy Judge's order. Most were leased at cost. This was a tremendous advantage for Continental, one it still enjoys, but one that it could not have achieved if it were not owned by a solvent parent willing to make the investment to save the subsidiary. Indeed, without Texas Air's assistance, Continental could not have obtained the aircraft at all, and might not have succeeded in its reorganization.

Eastern will be deprived of access to this kind of support in bankruptcy if this legislation forces Texas Air into Chapter 11 as well.

S. 544 also may impact adversely the position of Eastern's creditors. Section 4 does not stop with the requirement that each entity affiliated with Eastern undergo bankruptcy under chapter 11. Section 4 also provides that from the commencement of the chapter 11 cases, all of the airlines "shall be deemed substantively consolidated." "Substantive consolidation" is a term of art in bankruptcy. It means that each debtor's assets become available to pay each other debtor's liabilities. A pooling of assets and liabilities would occur without regard to the existing rights of creditors and stockholders. The assets of Eastern would be subjected to the liabilities of Continental Airlines, Inc. and Texas Air Corporation. Likewise, the assets of Continental and Texas Air would be subjected to the liabilities of Eastern.

If you are a bondholder of Eastern, you purchased your bond in reliance on Eastern's assets and liabilities, and in further reliance on Texas Air's liabilities being separate and not liabilities of Eastern. Pursuant to S. 544, however, Eastern would be liable for liabilities of Texas Air and Continental as well.

The purported rationale for the wholesale disregard of the separate corporations of Texas Air, Continental and Eastern is that Texas Air has drained Eastern's assets. S. 544 ignores, however, that the Bankruptcy Code already provides for the avoidance of all fraudulent transfers of assets from Eastern to Texas Air or anv other company. Eastern and its creditors, under existing law, may recover from Texas Air any assets wrongfully transferred. Indeed, such avoidance actions could have been commenced by creditors prior to the Eastern chapter 11 case. Every State in the United States has a fraudulent conveyance statute.

Likewise, existing law makes provision for creditors to reach the assets of a parent company of a subsidiary in chapter 11 if, after notice and hearing, it is determined by the bankruptcy judge that impermissible control, fraud or intermingling has occurred. See, e.g., Gibraltar Savings v. LDBrinkman Corp., 860 F.2d 1275 (5th Cir. 1988); U.S. v. Jon-T Chemicals, Inc., 768 R. 2d 686, 691 (5th Cir. 1985), cert. den., 475 U.S. 1014 (1986).

S. 544 goes much further, of course, than merely to require the return to Eastern of assets wrongfully transferred. It requires that all of Texas Air's and Continental's assets -- wrongfully transferred from Eastern or not -- be made available to Eastern. This is punitive. It deprives Continental and Texas Air of the opportunity they have under existing law to produce evidence and proof that assets allegedly transferred wrongfully were legitimate business decisions, that were in all instances fair to Eastern.

Indeed, for the Congress to make this judgment based on no evidence other than the unions' unsupportable allegations is both dangerous and unfair. After an exhaustive examination of the unions' evidence, the Department of Transportation and the United States Court of Appeals for the District of Columbia Circuit concluded that the unions' allegations were not supported by the evidence. And through seemingly endless litigation, the unions have had unprecedented access to Eastern's internal files, but were still unable to marshal facts to support their wild asset transfer allegations. The central assumption that underlies this Bill, therefore -- that Texas Air "has drained [Eastern] of its assets and cash reserves" demonstrates a prejudgment of this issue that is in direct contradiction to findings of fact made by two impartial tribunals.

Eastern and Texas Air are prepared to defend their actions again, on the merits, in Bankruptcy Court, where the unions will have a full and complete opportunity to attempt to prove the truth of their allegations. Indeed, this past Tuesday, Eastern requested that the Bankruptcy Judge appoint an Examiner to investigate these "asset transfer" allegations. The fact that the unions have moved this battle into the political arena suggests they are doubtful they ever will be able to convince an impartial trier of fact that these allegations have any merit. If we are wrong, and are unable to defend our business dealings, the Court has ample power to make sure that Eastern's creditors are fully protected.

It has been stated that S. 544 can be justified on the basis that controlled group members sometimes are liable for pension obligations of one another under ERISA. ERISA, however, was enacted pursuant to a national policy to protect pensions earned by all Americans. There is no national policy to override the power of the States to organize corporations having limited liability. Indeed, if Congress were to enact S. 544, investors could no longer purchase bonds or stock of any airline without the fear that if that company were to purchase another company that was in financial difficulty, their investments could be made worthless. This would have the direct and necessary effect of making airlines more difficult to finance. Indeed, as will be discussed below in more detail, this Bill threatens the marketability of airline debt and equity instruments in a variety of ways, and calls into question the future viability of airline deregulation.

The inequities of S. 544 are compounded by its Section 5. Pursuant to Section 5, S. 544 would be retroactive to March 8, 1989. There can be no penalty more unfair to Eastern and its bondholders than to subject them to legislation changing their rights and liabilities without notice. Senator Metzenbaum states that since he announced his legislation on March 8, Eastern was on notice of this fact on the day it filed its petition, March 9, 1989.

On notice of what? On March 8, 1989, Eastern was on notice of nothing upon which it could rely in making the most important business decision in its history other than the provisions of existing law. On March 8, Eastern knew that under the existing provisions of Chapter 11, its creditors were not exposed to the liabilities of Continental or Texas Air. It also knew that one Senator had introduced a bill that would, if enacted into law without amendment, substantially alter those rights. At the time, Eastern was totally shut down, and was bleeding to death at an alarming rate. What was Eastern to do? Wait for as long as it might take for this legislation to work its way through the Congress and the President to see if it would be enacted, and if so, in what form? If that had been Eastern's decision, its cash reserves would have been totally consumed long before this Bill could ever become law, and Eastern would be in liquidation. Eastern's only option was to rely in good faith on existing law and act prudently and responsibly, in the best interests of its creditors, stockholders and employees, which is precisely what Eastern did.

It would be manifestly unjust to change the rules retroactively on Eastern in this manner and we are confident that a court would strike down Section 5 on this basis. See, Thorpe v. Housing Authority of City of Durham, 393 U.S. 268 (1969).

Specifically, if the Bill were enacted and retroactively applied, Eastern would suffer manifest injustice because it would be forced to assume substantial additional liabilities when it was its inability to manage its own liabilities in the situation in which it found itself that caused its financial demise.

Finally, in addition to lowering the "controlled group of corporations" threshold, the Bill also proposes to prohibit an air carrier from modifying its collective bargaining agreements, even though a modification might be the indispensable key to a successful reorganization. The

Bankruptcy Code already contains provision for the interaction of collective bargaining agreements and debtors in bankruptcy. Specifically, Section 1113 of the Code deals with a Chapter 11 debtor-in-possession's rejection of a collective bargaining agreement. Given that Congress has enacted legislation to deal specifically with the issue of collective bargaining agreements of a Chapter 11 debtor, the Bill's attempt to thwart Eastern's ability to utilize the protections afforded a debtor in bankruptcy is an unwise and vindictive undermining of Chapter 11 as amended.[1]

S. 544 Will Undermine Investment in the Airline Industry and Make the Industry Less Competitive.

Apart from the draconian effects this bill will have on Eastern, Continental and Texas Air, it holds the promise of seriously undermining the ability of businesses in the United States to finance airlines. This, in turn, has serious implications for deregulation, competition and investment in this industry.

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[1] Section 1113 requires that: (1) the debtor make a proposal to its unions; (2) such proposal be based on the most complete and reliable information available at the time of the proposal; (3) the proposal may only provide for such modifications to the the collective bargaining agreements as are necessary to permit the reorganization of the carrier; (4) such proposal must treat all parties in interest "fairly and equitably"; (5) the debtor must provide relevant information to the unions to enable them to evaluate the proposal; and (6) the debtor must meet with the unions "at reasonable times" to

As discussed previously, the Bill dramatically lowers the threshold for involving parent companies and other corporate relatives in an air carrier subsidiary's bankruptcy. This change has far reaching implications for the entire industry. In the future, no corporation would or could consider acquiring a troubled airline, since if the airline were to fail after the acquisition, the acquiring company would suddenly find itself thrown into bankruptcy. No responsible businessman would subject a healthy, viable company to such a risk. The Bill virtually guarantees, therefore, that Pan American either makes it on its own, or gets liquidated.

For similar reasons, the prospect of an ongoing business starting up a new airline business in a wholly owned subsidiary, especially in a greater than normal risk environment, also will be eliminated by this Bill.

And existing airline holding companies will have to reevaluate whether to continue with the holding company structure. Holding companies, of course, are normal kinds of business organizations, and they provide the overall entity with distinct advantages, including greater flexibility in tapping different segments of the financial market, and

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permit negotiation "in good faith" to attempt to reach "mutually satisfactory modifications" of the collective bargaining agreements. If the unions refuse the debtor's proposal "without good cause", then, and only then, may the Bankruptcy Judge permit the rejection of the collective bargaining agreements.

achieving a variety of efficiencies in consolidating administrative, legal and corporate functions. All but one of the major United States airlines are presently organized in holding companies.

If S. 544 becomes law, every one of these companies will have to consider whether the loss of limited liability at the parent and other affiliates is too great a risk to keep the airline subsidiary within the corporate family. For example, S. 544 would require all lenders to severely alter the credit practices that they apply to future loans of affiliates of air carriers. Because the bankruptcy of the air carrier could force all of its affiliates into bankruptcy, a prudent lender could not agree to provide credit to an affiliate of the air carrier without undertaking a complete credit evaluation of not only its borrower, but also of the air carrier affiliate and all other affiliates of the borrower (based on the 30% test). The lender would find it necessary, because of the consolidation provisions discussed above, to require adequate guaranties and security from all affiliates of its borrower to protect its position. Even if the affiliates were willing to provide such security (a significant question because of the low 30% ownership test contained in S. 544), this procedure would raise transaction costs and tie up assets that might be used for other purposes.

With these kinds of disadvantages to owning an airline, airlines may be spun off, and left to fend for themselves, losing access to the many benefits derived from being a part of a holding company. This inevitably will make financing airline ventures less efficient, and therefore more expensive. At a time when the airline industry has to spend billions of dollars on new generation aircraft, imposing this needless expense may severely impact the industry's ability to buy new, modern and environmentally sound aircraft. It most certainly will impede if not terminate any chance that new entrants will be a part of that growth.

For these, and other reasons, S. 544 would immediately restrict access to credit by all affiliates of air carriers, including other air carriers, and force them to turn to more expensive and less desirable sources of financing.

Conclusion

The current Eastern financial problems did not start in 1986 when Texas Air acquired Eastern and Frank Lorenzo became its Chairman. The only thing that changed in 1986 was the surname of the Frank who the unions nominated as designated whipping boy for Eastern's problems under deregulation. The losses continued, and the rancor continued.

Once airline deregulation made airline tickets competitive, Eastern's inflated wage rates were exposed to unrelenting competitive pressure. Excess revenues were no longer available to fund union salaries and costs built up and negotiated in a regulated environment. Apparently, Eastern's unions would rather fall on swords to demonstrate the depths of their frustrations with what has befallen them in the last ten years, than make the necessary adjustments to permit Eastern to continue as a going concern. Eastern, Texas Air, Continental, their affiliates, and the men and women who do want to work at Eastern now should not be punished, however, because the unions have chosen a suicidal path to oblivion.

Please do not aid and abet an ill-conceived effort on the part of Eastern's unions to punish Eastern and its affiliates for the effects of deregulation. That in essence is what S. 544 does. Moreover, aside from its effects on Eastern, this retroactive type of legislation would establish a dangerous precedent for solving the legitimate needs of debtors under the Bankruptcy Code, and is clearly not designed to deal constructively with either the legitimate labor of bankruptcy issues. It should not be enacted. It is an arbitrary and unreasonable use of the bankruptcy power which violates Article I, Section 8, Clause 4 and the Fifth Amendment of the Constitution.

Thank you for the opportunity to appear before the Committee to submit the views of Texas Air and its affiliates.

Responses of Texas Air
to
Questions of Senators Thurmond, DeConcini Metzenbaum and Biden

Questions Submitted by Senator Thurmond

1. Mr. Seiden, if this legislation is enacted, what effect will it have on the ability of Eastern Airlines to continue to do business:

Answer: This legislation will have a devastating effect on Eastern's ability to continue to do business. Now that Eastern is operated under the control and jurisdiction of the Bankruptcy Judge, it cannot take any significant business decision without the Court's approval. The approval process is one designed and intended under the Bankruptcy Code to accommodate a variety of competing interests -- those of Eastern's secured and unsecured creditors; those of Eastern's ticketholders; those of Eastern's employees; those of Eastern stockholders, and finally, those of the traveling public.

The creditors have formed committees to represent their interests, and as of now, they have a pretty good idea of where they stand financially in respect of their loans. They all researched Eastern carefully before making their loans, and satisfied themselves that Eastern, as they knew it, was a creditworthy risk. In considering proposals by Eastern's management to operate and restore itself to viability, they are in a good position to judge, based on facts known today, whether such plans are in their financial interests.

S. 544 will throw Eastern's creditors into chaos because it would throw Continental and Texas Air (and all other affiliates) into Chapter 11 with Eastern, and "substantively consolidate" their debts with those of Eastern. In other words, S. 544 will give all creditors of all companies equal rights to look to the assets of all affiliates to satisfy their claims. S. 544 will force Eastern creditors into competition with creditors of Continental and Texas Air for satisfaction from a new and different body of assets which they never examined. This will substantially undermine their ability to assess reasonable business plans that Eastern might make.

This uncertainty will be exacerbated by the fact that Continental probably will founder in Chapter 11 since its advance bookings will evaporate if forced to file for bankruptcy, and it will have to substantially curtail operations to reflect its new, lower level of patronage. That in turn will have the effect of turning many present Continental ticketholders into creditors of the combined estate. These creditors, too, will be able to look to Eastern's assets for compensation, further complicating the task for Eastern's present creditors in assessing Eastern's reorganization plan.

Similarly, since Texas Air and Continental creditors will have a financial stake in Eastern's reorganization, they too, will have to pass on Eastern's business plans. Since they are unfamiliar with Eastern's financial situation, they will be hard pressed to come to informed decisions regarding Eastern's reorganization. In sum, combining all Texas Air companies in Eastern's bankruptcy will severely complicate the task of reorganizing Eastern.

Not only will S. 544 undermine Eastern's ability to reorganize itself under present management, it will also severely undermine the possibility that outside investors will be interested in purchasing Eastern out of bankruptcy, and reorganizing it. If S. 544 becomes law, any prospective purchaser will have to contend with the possibility that if its investment in Eastern proves unsuccessful, and Eastern has to file for Chapter 11 again, the purchaser will have to go into bankruptcy also. At a minimum, that will tend to depress the amount an investor would be willing to pay for Eastern, lessening the chance that the amount will satisfy all creditor claims; it could scare off potential purchasers entirely. And since, as discussed above, all Texas Air and Continental creditors will have the right to look to Eastern assets to satisfy their claims in bankruptcy, that, too, will make it considerably more difficult for a purchaser to wrap up the Eastern bankruptcy, and emerge from Chapter 11 as a new and revitalized company.

This is ironic, since Eastern's unions profess publicly a desire to arrange the purchase of Eastern by outside investors, yet they simultaneously seek passage of this legislation, which has the inevitable effect of diminishing the chance that such a purchase can happen.

Finally, the Bill prohibits Eastern from utilizing Section 1113 of the Code to avoid its labor contracts, if such should be required for a successful reorganization. While it should not be assumed that the course of this bankruptcy will involve such a step, making Section 1113 unavailable to Eastern deprives Eastern of a potentially significant form of financial relief and further lessens the chances of Eastern continuing to do business.

2. How will this legislation affect Texas Air, the parent corporation of Eastern Airlines? In addition, how will this bill affect Continental Airlines, a subsidiary of Texas Air?

Answer: The Bill will force Texas Air and Continental needlessly to file for bankruptcy. Today, they are solvent viable companies. Continental is the fifth largest domestic airline, and provides important consumer services. If S. 544 becomes law, both would suffer the trauma and great expense -- needlessly -- of bankruptcy proceedings. We estimate, for example, that the expenses directly attributable to Continental's 1983 bankruptcy cost in excess of $78.8 million. The costs for the bankruptcies mandated by S. 544 undoubtedly would far exceed this amount, because it would be a far more complicated transaction.

Moreover, bankruptcy could destroy Continental entirely as an operating airline. Passengers and travel agencies have learned the hard way that many travelers suffer great inconvenience and financial harm by doing business with a bankrupt airline. Thus, if Continental were forced into Chapter 11, its advance bookings would dry up immediately.

Without passengers to serve, Continental would have to scale back substantially its flight operations to a small core operation, thus giving effect to consumers worst fears.

Whether Continental could survive such a sudden loss of patronage is in serious doubt. Continental has just suffered two of the most difficult years ever experienced by a United States airline, as it struggled to absorb the dead and moribund operations of Frontier Airlines, and People Express. Continental has just started to see daylight. It expects to be profitable in 1989. But Continental has been weakened by the events of 1987 and 1988 and a bankruptcy at this stage of its recovery may be more than it can bear.

Texas Air itself is a classic holding company. It employs under 50 people, and conducts no operations of its own. Its only significant assets are the shares it holds in Continental and Eastern and System One. Since the future of those companies will be placed in jeopardy by S. 544, Texas Air fortunes will be adversely affected as well.

3. **What has been the effect of the dispute at Eastern Airlines upon small commuter airlines that derive much of their business from Eastern?**

Answer: As the question implies, the effect on Eastern's commuters has been very damaging. The airline industry has evolved into a hub and spoke network, and every hub jet carrier makes arrangements with one, and rarely more than one, commuter carrier to provide feed traffic to the jet operator from small communities that cannot support jet service. Thus, Eastern's commuters were closely tied to Eastern, and without Eastern, have few options in terms of alternative jet operators with whom they can exchange traffic.

4. Mr. Seiden, could you describe for us the effect this dispute has had on consumers, namely, Eastern passengers and holders of tickets on Eastern Airlines?

Answer: With the exception of service to South America, and the Shuttle services, most passengers who wish to fly Eastern today cannot do so, because most other Eastern services are shut down. While Eastern is working hard to restore service to additional markets, as it obtains the services of additional pilots, this is a slow process.

Holders of Eastern tickets have several options to recover amounts spent on advance bookings. Ticketholders on routes that Eastern still flies can use those tickets without modification and Eastern will honor them. Ticketholders for services that Eastern presently does not provide can exchange those tickets for scrip and use the scrip to purchase 25% of the value of a ticket on Eastern on a route Eastern presently does fly. That scrip holder can use the scrip repeatedly in this fashion until the entire value of the scrip is expended on new tickets. In addition, the ticketholder can hold the ticket until such time as Eastern restores service in the market covered by the ticket, and at that time, Eastern will permit the holder to use the ticket, and to bring a companion along for free. Moreover, other airlines, and Continental in particular, have agreed to transport Eastern ticketholders with certain restrictions, depending on the type of ticket presented.

If none of these options is available, ticketholders who purchased tickets with credit cards can exercise their rights under federal credit laws, and upon receipt of their monthly statement from the credit card company, refuse to pay for these unused tickets. Noncredit card purchasers who desire refunds can present their claims to the bankruptcy court, and compensation will be authorized in the context of the overall reorganization. In the Continental Airlines bankruptcy, such ticketholders received 100 cents on the dollar, with interest.

5. Mr. Seiden, do you believe there is any serious threat of secondary boycotts which could disrupt commuter service around the country?

Answer: No, I do not believe so. The unions have threatened to hold the country hostage to this dispute in the hope their threats could scare the President and the Congress into legislating a Presidential Emergency Board. President Bush and Secretary Skinner stood up to these threats, and secondary boycotts have not materialized. Several courts have issued restraining orders forbidding such activities, and there is no reason to suppose that such threatened activity might materialize now, more than five weeks after the onset of the strike at Eastern.

Questions Submitted by Senator DeConcini

1. In your written testimony you state that without the asset sales made by Eastern, the Company would have run out of money. If this is true, how do you justify Eastern's purchase for 30 million dollars of the nearly bankrupt People's Express note, due in 2012?

Answer: Texas Air acquired People Express for the benefit of Continental and Eastern, and it was originally intended that each such company participate financially in the acquisition. Indeed, in the first quarter after the People Express acquisition, Eastern earned an operating profit. largely as a result of a substantial curtailment of People Express's operations in Newark - Florida markets.

Continental subsequently purchased People Express from Texas Air. However, since the Eastern acquisition was not consummated until after the terms of the People Express acquisition were determined, and since Eastern's loan agreements prevented it from contributing to the purchase price for People Express, Eastern instead purchased from Texas Air $30 million principal amount of People Express marketable securities for a purchase price of $25 million. Texas Air had purchased approximately $100 million of such People Express securities in the open market in order to facilitate the People Express acquisition. Drexel Burnham Lambert and Morgan Stanley & Company, independent investment bankers, advised Eastern that $25 million was a fair price for such securities at the time of the purchase.

At the time of this investment, Eastern had substantial cash invested in short term instruments returning 6 to 6-1/2 percent. The People Express notes yield 12 percent to maturity, which is in line with the market rate at the time of the purchase. Accordingly, Eastern succeeded in increasing substantially the return on its cash by making this investment. Since the purchase, Eastern has received a check every six months -- cash -- for $1.5 million, the interest earned on its investment. This is a substantially better return than Eastern earned on its airline operations since late 1986, during which Eastern lost almost three quarters of a billion dollars.

There is an irony present here, as one contemplates the effect of S. 544 on this transaction, and Eastern's interest in it. Today, the obligor on this debt -- People Express -- is solvent, and makes a significant payment to Eastern every six months. Indeed, in the two and one half years since the purchase of the bond, Eastern has received from People Express approximately $7.5 million in interest, on an investment of $25 million. The creditworthiness of the bond likely will become stronger in the next few months, since Continental has announced plans to merge People Express into Continental, which will make this obligation a Continental obligation, rather than a People Express obligation.

If Continental is forced into bankruptcy, however, its creditworthiness will evaporate, and its obligation to pay interest on this bond will be suspended by operation of the

Bankruptcy Code. Thus, Eastern will be significantly worse off than it is today if S. 544 becomes law since it will lose $3 million in interest income each year, and also will see the market value of this note diminish substantially, if it is not eliminated altogether.

2. You stated that when Continental was in Chapter 11, it benefited by leasing, at cost, 55 brand new Boeing 737-300 aircraft from Texas Air, but that this would not be possible for Eastern under the proposed legislation. Wouldn't it be possible for the bankruptcy judge to approve of this type of arrangement if he found it was in the best interests of the corporations?

Answer: Yes, the bankruptcy judge could approve such an arrangement if he found it was in the best interests of the corporations. The reason such a transaction could not occur is because Texas Air, in bankruptcy, could not raise the financing itself to purchase the airplanes in the first place. It was precisely because Continental, as a bankrupt company, could not raise financing for new aircraft that Texas Air had to step in and use its sound credit standing to raise the capital to buy the planes that it then leased to Continental at cost. In bankruptcy, however, Texas Air's creditworthiness would be no better than Continental's was in the period 1983-1986; indeed, it would probably be worse, because this Bill will require that every company affiliated with Texas Air also be in bankruptcy, making this bankruptcy unusually complicated. It is virtually impossible to imagine any creditor lending any money to Texas Air (or any affiliate) for any purpose in such circumstances.

3. According to your testimony, existing statutes cover the problem of "asset-stripping" by a company. Isn't it true, however, that in order to recover under a fraudulent conveyance statute Eastern's creditors would have to show that Eastern was insolvent at the time it transferred the assets?

Answer: No. The Bankruptcy Code provides alternative mechanisms by which assets improperly transferred may be recovered. Section 548 provides two bases for avoiding such transfers: (1) actual fraudulent intent, and (2) constructive fraudulent intent. The actual intent standard does not require insolvency on the part of the chapter 11 debtor.

Section 548(a)(1) of the Bankruptcy Code provides that an asset transfer may be set aside as a fraudulent conveyance, if the transaction was entered into "with actual intent to hinder, delay or defraud creditors." For purposes of this subsection, however, actual intent can be demonstrated by conduct and does not require affirmative proof concerning the transferor's intent.

Section 544(b) also provides a mechanism to avoid improper transfers. Under this section, state law may be used to avoid such transfers if an actual creditor with an allowable claim would have such a right. In addition, section 544(b) by its use of state law allows the exploitation of state statutes of limitations that often permit the avoidance of transfers made beyond the one-year limit imposed by section 548. Similarly, section 7 of the Uniform Fraudulent Conveyance Act and section 4(a)(1) of the Uniform Fraudulent Transfer Act provide identical relief where the transfer was made with actual intent to hinder, delay or defraud creditors. Most states have codified either the Uniform Fraudulent Conveyance Act or the Uniform Fraudulent Transfer Act. Accordingly, Eastern's creditors need not address the issue of Eastern's solvency in order to set aside an asset transfer, so long as they can demonstrate that such transfer was made with actual intent to hinder, delay or defraud creditors.

4. Do you believe that the Bankruptcy code adequately protects the rights of ticket-holders, and if not, what changes do you recommend?

Answer: The Bankruptcy Code clearly provides adequate tools for the bankruptcy judge to protect the rights of ticketholders. Accordingly, I do not believe that there is a need to change the Code to afford claims of ticketholders automatic priority over other unsecured claims. Although some ticketholders may be individuals who have purchased tickets for personal use, other ticketholders are individuals, corporations and other entities, which have purchased tickets for business purposes. There is no basis for distinguishing between such claims and other claims of similar rank.

On the other hand, we believe that it is quite appropriate for bankruptcy courts, in the exercise of their equitable powers, to afford special treatment to claims of ticketholders where such treatment is consistent with the rehabilitative purposes of chapter 11. In two previous Chapter 11 proceedings with which Texas Air companies have been involved, Frontier and Continental, ample provision was made to address the legitimate needs of ticketholders.

In the Continental Airlines reorganization, the bankruptcy court approved Continental's programs whereby scrip for travel on Continental was exchanged for prepetition ticketholder claims, thereby affording ticketholders an opportunity to satisfy their claims without awaiting confirmation of a reorganization plan. Ticketholders who did not desire to participate in these programs received under Continental's reorganization plan cash payments, with interest, equal to 100% of the amount of their claims.

Similarly, in the Frontier Airlines chapter 11 case, the bankruptcy court approved a credit for travel program whereby Frontier ticketholders could use their tickets for travel on Continental.

In the Eastern Air Lines chapter 11 case, the bankruptcy court has authorized the use of tickets on Eastern and on Continental, Eastern's affiliate. See discussion at 6-7 supra. As and when Eastern is able to increase its passenger operations to at or near pre-strike levels, this program will be of increasing benefit to ticketholders.

These programs represent carefully crafted and reasonable programs to address the needs of ticketholders in the Eastern bankruptcy. By virtue of the major decline in the value of outstanding tickets, see discussion at 14 infra, it appears that these programs are working as intended. We believe it would be unwise to interfere with the power and flexibility of bankruptcy courts to fashion remedies which protect legitimate ticketholders' interests, while minimizing the potential adverse effect on the debtor and its other creditors.

Questions Posed by Senator Metzenbaum

1. Please provide net worth, profit and loss and cash data for Jet Capital Corporation.

Answer: For the year ending 1988, Jet Capital's net worth was approximately $1.01 million. Its total Assets for YE 1988 were approximately $1.32 million, and its total liabilities were approximately $270.000. At YE 1988, Jet Capital had cash and marketable securities of approximately $723,000.

Jet Capital's profit (loss) results in the years 1985 through 1988 were as follows:

(in millions of dollars)

1985	1986	1987	1988
3.3	4.2	(3.1)	(1.1)

The data for 1988 are approximate, preliminary and unaudited. The data for earlier years are audited . The earnings (losses) data include earnings (losses) associated with Jet's common stock investment in Texas Air.

2. How much does Eastern owe to travel agents and ticket holders. How much of that amount constitutes transportation sold in the last month before the strike and shut down, and how much represents transportation sold as a result of "cut-rate" promotions?

Answer: On the date Eastern filed for bankruptcy, it estimates that the monetary value of unused tickets outstanding was approximately $170 million, of which approximately $70 million consisted of credit card purchases, the payment of which could, under federal credit laws, be avoided in light of the cancellation of Eastern's flights.

By March 23, Eastern estimates that the $100 million in noncredit card purchases had been reduced to approximately $50 million, by virtue of the various travel options discussed in response to Question 4. posed by Senator Thrumond.

Based on normal purchase patterns, Eastern estimates that approximately 65-70% of the $170 million outstanding on March 9 was purchased in the preceding 30 days. While we do not have precise figures, we believe that very little of this liability was incurred as a result of special "cut-rate" promotions. We say this for two reasons: (1) The most significant cut-rate promotion promised coupons, to be handed out on board Eastern flights, good for discounts on travel after March 4 (the strike deadline) to passengers who travelled before March 4. Thus, all coupon recipients actually received the transportation that they paid for. The coupon merely afforded the passenger a discount for transportation booked after March 4, and we doubt that many passengers (other than those using the Shuttle and Eastern's service to South America) have attempted to make reservations on Eastern after March 4.

(2). To promote travel in the last two weeks of the "cooling off" period, leading up to the March 4 deadline, Eastern dropped its advance purchase requirements, so that passengers could book on Eastern at discount prices, and travel immediately -- before the strike deadline. This relaxation of advance purchase requirements had the effect of lowering the amount of transportation sold for travel after March 4.

Finally, Eastern does not believe that it owes travel agents any more than nominal amounts. There are only two scenarios by which Eastern could owe travel agents money. Both derive from possible business practices of individual travel agents over which Eastern has no control or influence. First, some travel agents may have chosen to refund on their own unused tickets that were paid for in cash. To the extent this happened before Eastern filed its Chapter 11 petition, these travel agents would have claims against Eastern. Eastern has no records of the extent to which this occurred. Second, some travel agents may extend credit themselves to large accounts, requiring payment some time thereafter. In such circumstances, it is possible that some tickets were sold before the filing of Eastern's petition, the travel agent remitted the money to Eastern, and then was unable to collect from its client because of the strike and bankruptcy. Here, too, Eastern does not believe that the amounts involved would be any more than nominal, but Eastern has no records to establish whether, and the extent to which, this actually occurred.

Question Posed by Senator Biden

You have stated that during the February-March "cooling off" period, Eastern experienced a significant decrease in bookings, as passengers and travel agents "booked away" from Eastern in anticipation of a possible strike. Please provide evidence of such booking away activity.

Answer: The attached graph, based on company records, demonstrates the dramatic fall-off in advance bookings that Eastern experienced during the cooling off period. Eastern surveys its advance bookings every three to four days. The numbers under the base line indicate the exact days Eastern conducted this survey for 1989 (the first line of numbers) and for comparable days in 1988 (the second line of numbers). The lines on the graph represent the difference in advance bookings between 1989 and 1988 on each of the survey dates reported.

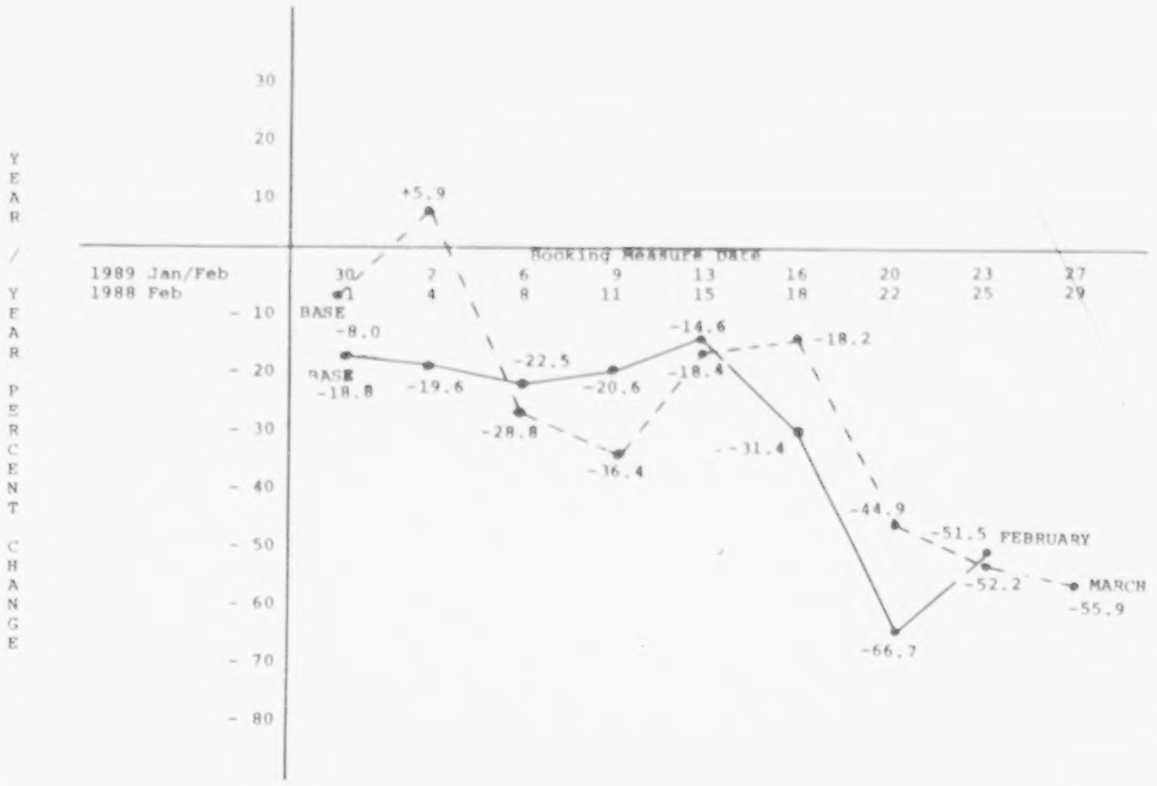
The data indicate that in the first two weeks of February, Eastern's incoming advance bookings for trips to be taken in February (the solid line) were 20% below 1988 levels. In the last two weeks of February, the rate of decline skyrocketed to the 60 - 70 percent range.

February incoming advance bookings for March travel do not look any better. The dotted line, representing incoming February advance bookings for March travel, indicates that from February 4 - 16, incoming advance bookings were down by 20-35%, and that in the last two weeks, the rate of decline jumped to the 45-55% range.

These disastrous booking patterns are inherent in the nature of operations conducted in a cooling off period. We believe that this pattern would be significantly worse under any cooling off period that might be mandated by Presidential Emergency Board legislation pending in Congress for several reasons. First, Eastern already has lost all advance bookings by virtue of the strike. Many loyal Eastern customers have now established commercial relationships with Eastern's competitors, including enrolling in their frequent flyer programs. It will be difficult to win these customers back. Compounding this difficulty is the uncertainty surrounding

Eastern's operation. It is hard to imagine customers booking beyond the expiration of the cooling off period, since they cannot know whether Eastern will actually be flying in that period. Moreover, passengers will be concerned about Eastern's reliability during the cooling off period. Since Eastern previously has experienced severe job actions, such as the infamous "Max Safety" slow-down discussed in my written statement of March 17, many potential passengers will stay away to avoid potential disruption.

3/31/89 Incoming Bookings - Percentage Change 1989/1988



Senator **Metzenbaum**. Thank you very much. I must say the Chair, the author of the bill, does not understand that his legislation is retroactive. It was put in on March 8, and we do have many instances in the Congress of the United States where legislation is introduced and, by its terms, indicates that it is to be effective as of the date of introduction. We do it with respect to most tax legislation.

Let me ask a question of Mr. Seiden. Mr. Winpisinger and Mr. Duffy said that their people would go back to work on the same terms as those that existed when the company went into bankruptcy if there were to be an emergency board appointed, as has been done in 34 previous cases over the last 40 years.

Does the company oppose the appointment of an emergency board?

Mr. **Seiden**. Absolutely, we do, sir.

Senator **Metzenbaum**. Mr. Winpisinger and Mr. Duffy also indicated that they would go back to work under the same terms provided there were binding arbitration, a procedure that is used in many places throughout this country by major national corporations and large national labor unions.

Would the company accept binding arbitration at this point?

Mr. **Seiden**. No, Senator, we would not. If I may, Senator, I would like to elaborate on my answer to your first question about the circumstances that would surround the possibility of the members of the IAM and ALPA and the TWU, all of the working employees of Eastern Airlines as of March 8, coming back to work if a Presidential Emergency Board were put into place.

Today, as is all too apparent to us at Eastern and to everyone who likes to fly Eastern, most of the airline is not in operation. We have literally no bookings in the pipeline for obvious reasons. We have people who fly the shuttle today, and we have people who use our services to South America. But, obviously, people are not booking on Eastern Airlines to fly from Washington, DC, to Atlanta today. So there are literally no bookings, and I do not exaggerate when I say that. No bookings right now in the Eastern pipeline.

If as a result of the Presidential Emergency Board becoming law we were required suddenly to start operating an airline, a full airline, as if we had a full inventory of bookings to serve, we would lose incredible amounts of money because the planes would be flying empty for quite some time. So we could not afford to employ all these employees.

Now, it has been said that, well, perhaps we could take them back under the terms of the contract but then furlough them. That, too, is not the case. The furlough provisions in the three contracts that we have with the respective labor organizations require advanced notice before furloughs may take place. My understanding is the advanced notice requirements in all of those contracts would prohibit any furloughs before the PEB would have expired.

Second, furloughing pilots is a very long and laborious process because of the seniority situation in the way pilots get to bid on their flight requirements. There is a bumping process, Senator, as perhaps you know. As you bump pilots down the seniority list, they all have to be retrained because they frequently end up flying different types of equipment than the type of equipment they bid on. So that furloughing pilots is a very slow, laborious process.

In summary, the prospect of Eastern having to put back on the payroll 30,000 employees and operating a 240-aircraft fleet with no passengers on it for virtually the whole duration of the Presidential Emergency Board would cost Eastern untold millions of dollars.

Senator **Metzenbaum**. Assume that interim situation could be worked out. Is it my understanding that you oppose the appointment of an emergency board before you shut down? Is that correct?

Mr. **Seiden**. Yes, it is, sir.

Senator **Metzenbaum**. So then assume the problem of getting the reservations into the pipeline could be worked out in some amicable way, would Eastern be willing to accept the appointment of an emergency board?

Mr. **Seiden**. No.

Senator **Metzenbaum**. All right. Senator Biden.

I do have some additional questions for you.

The **Chairman**. I will take just a few here.

Senator **Metzenbaum**. That is okay.

The **Chairman**. If I may ask, Mr. Seiden, why did you oppose the board in the first place while you still had a lot in the pipeline—including some of my tickets, by the way? [Laughter.]

Mr. **Seiden**. That is one of our problems in the industry, Senator Biden.

Senator **Metzenbaum**. The Senator from Delaware has been precluded from voting on this bill. He has a conflict of interest.

The **Chairman**. That may be my only way out. [Laughter.]

Mr. **Seiden**. Senator, we opposed the Presidential Emergency Board because the cooling off period that is involved with the Presidential Emergency Board would have put Eastern Airlines into an untenable financial situation. Its cash reserves were running dangerously low at the time the board was under consideration. And trying to operate an airline in those circumstances is very costly and very difficult. Let me explain why. And it is part of the problem Eastern has had such a severe financial problem, particularly in the last 3 months.

Eastern's problems have been no secret to the travel agent community and to the flying public. As a result of the possibility of an impending strike at Eastern Airlines, many travel agents have done all they can to book away from Eastern Airlines to protect their customers from what happened on March 9.

That situation existed throughout the whole of the 30-day cooling off period that previously existed under the Railway Labor Act, and it, in fact, existed for some several months leading up to that because one never knew when it might happen.

The **Chairman**. I guess I do not have a very good travel agent.

Mr. **Seiden**. Well, we are grateful for your travel agent's faith in Eastern. We are sorry we had to disappoint you and your travel agent.

But the fact of the matter is that during the duration of the PEB, you would basically find Eastern's planes occupied only by people who literally had no other choice, had no other way to go.

People would not be booking on Eastern in terms of advanced bookings beyond the time when a strike might resume.

The **Chairman**. Can you provide for this committee evidence of the fact that you are stating, that preceding the 30-day cooling off period there was a decrease in bookings of *x* amount compared to what there was the month before? Can you provide that?

Mr. **Seiden**. I will try to get some evidence to that effect, Senator. I do not have it with me now.

Senator **Metzenbaum**. While you are doing that, I might ask you also if you can tell us how much Eastern owes to travel agents and ticket holders as a class of unsecured creditors. Do you know that?

Mr. **Seiden**. I do not know that today, Senator, but I will try to find that out.

Senator **Metzenbaum**. Also can you tell us how much of that debt results from transactions in the last month before bankruptcy, including last-minute promotions for cut-rate tickets?

Mr. **Seiden**. I will try to get that for you, Senator.

Senator **Metzenbaum**. Thank you.

The **Chairman**. You said something interesting, and it struck a chord with me. You said in the beginning of your statement that if this bill became law that Eastern would be in a position—correct me if I am wrong now. I thought that at the beginning of your statement you said this would put Eastern in the position whereby it would become subject to so many creditors that were not its own creditors that it would not be in a position to pay. Why would a creditor go after Eastern instead of going after Texas Air or going after Jet Air Corps or going after Continental?

Mr. **Miller**. If I might, Senator, the bill contemplates what we call in bankruptcy substantive consolidation. The effect of substantive consolidation is to pool assets and liabilities. You completely eradicate corporate lines. So you have one ball of wax.

The **Chairman**. Right.

Mr. **Miller**. That means that all of Continental's public debt holders, that all of Texas Air's public debt holders will now be looking at one ball of wax.

The **Chairman**. Right.

Mr. **Miller**. The fact that they relied upon the credit of Texas Air when they bought a debenture in the public market would no longer mean anything. All of those assets and liabilities will be merged. It is not simply getting to the assets of Texas Air Corporation. It is also picking up the liabilities.

What you are talking about, your being stranded without a ticket, what this bill will do is strand all Continental's passengers and all of the passengers on all of the feeder lines. They will all be stranded if this bill becomes law, and they will all have claims for tickets. They will look to all these assets, and maybe these airlines will not fly. And as a liquidation value, there may not be enough assets to go around to all these people.

The **Chairman**. Mr. Seiden, would you recite again for me what your position is with the airline?

Mr. **Seiden**. I am Associate General Counsel with Texas Air Corporation, Senator.

The **Chairman**. I do not know whether you are under oath or not, but can you tell me whether or not you, Texas Air Corporation, from the outset planned on having, in effect, Eastern declare bankruptcy? Was that a preordained thing way out? Were you looking for an excuse to declare bankruptcy?

Mr. **Seiden**. I can tell you absolutely, without equivocation—and if you wish to put me under oath, Senator, I would be happy to be put under oath.

The **Chairman**. I will take your word for it.

Mr. **Seiden**. The answer to that is absolutely no. Absolutely not.

The **Chairman**. That was not the intention to take Eastern into bankruptcy?

Mr. **Seiden**. Absolutely not. And it was not even the intention to take Eastern into bankruptcy during the cooling off period. We did not reach that decision, I do not believe, until the night of March 8 when we had no alternatives. It was the absolute last option.

Mr. **Miller**. I would be happy to corroborate Mr. Seiden's testimony, Senator. I attended the board meeting on March 8, and that decision was not made—and it was not even made on March 8. They were waiting to see what happened on March 9. If the pilots had flown when the strike started at 12:01 on Saturday, and there was a revenue base coming into this airline, it would have never filed a bankruptcy petition.

The **Chairman**. You understand why I asked? At least the strong impression was that one of the incentives for taking Continental into bankruptcy was to abrogate the union contract. That may be a misunderstanding that many up here had, but that is what many of us thought. I think not only us, but a lot of commentators thought, too.

Mr. **Miller**. Senator, with all due respect, in the case of Eastern, absent a presidential board, the IAM contract has expired. So there is not a labor contract to be rejected.

The **Chairman**. No, no, it was not a question of rejecting or accepting, and I realize the law is no longer as it was in 1983. In 1983, the intention, most of us thought, of whoever decided that Continental should go into bankruptcy was to use that as a form whereby it could, in fact, deunionize the airline and that was the objective, viewed to be the sole objective by many people. That is the reason for my question in this case even though you cannot under bankruptcy law do what was done in 1983. That is the reason I asked the question.

Let me ask you this. As you know, the pilots have asked the bankruptcy court this week to appoint a bankruptcy trustee to run Eastern. Are you opposed to the appointment of such a trustee? And if you are, what are the reasons for your opposition?

Mr. **Seiden**. I am sure that we will oppose that, Senator. We have made our own motion for the appointment of an examiner to look into the various questions that have been raised for at least the third time, and probably more than that, in relation to the question of whether there have been impermissible asset transfers, so-called upstreaming. You have heard a lot of that mentioned this morning.

We have had opportunities to defend ourselves in at least two forums now in respect of those allegations. They were raised fully and completely by the unions before the Department of Transportation during last year's unprecedented fitness investigation of

Texas Air and its subsidiaries. And the Department of Transportation basically rejected the allegations that were made.

There has been a plethora of litigation involving Eastern and its unions, in here, in this district, in Florida, and last year, the U.S. Court of Appeals for the District of Columbia Circuit made findings of fact in its opinion that the allegations of asset transfers and upstreaming and bleeding off of assets were unfounded and could not be proved.

We are prepared to defend our business dealings again in the bankruptcy court and, in fact, have invited that inquiry so that the air could be cleared.

As to the other matter, I would defer to Mr. Miller.

Mr. **Miller**. If I could add, Senator, the Congress studied the bankruptcy laws for a long time between 1973 and the adoption of the Bankruptcy Reform Act in 1978. It used to be under the old Bankruptcy Act in corporate reorganization cases that the appointment of a trustee was mandatory. The study that Congress did at that time revealed that trustee administration of businesses was inefficient and, to a large extent, incompetent. The Congress decided in chapter 11 reorganizations that management should continue unless it was grossly incompetent or was engaged in fraudulent activities. That has been the standard in chapter 11 since the adoption of the Bankruptcy Reform Act of 1978. And chapter 11 has been a very successful means in a very credit-intensive society to reorganize businesses.

By comparison, if you go to the railroad reorganizations, where trustees are mandatory, the average life of the railroad reorganization is something between 10 and 20 years. The Missouri and Maine—whatever the name of the railroad is, took 35 years to reorganized under the aegis of a trustee.

The **Chairman**. May I ask one more question?

Senator **Metzenbaum**. Sure.

The **Chairman**. Then I will have no more, Mr. Chairman.

I would like to address this to you, Mr. Miller, because we heard from the pilots 'attorney who is an expert in bankruptcy, and I would like to hear from you, if I may, to educate me a little bit on this.

As I indicated earlier, as I understand the pension law, if Eastern misses a payment to its pension fund, Continental and Texas Air would be liable. Is that correct?

Mr. **Miller**. That is correct, sir.

The **Chairman**. Now, the pension law provides for reaching back to the affiliated corporations. If one of the corporations cannot meet the payments, why should not that same rationale be applied in the context of bankruptcy?

Mr. **Miller**. Well, I think as Senator Specter pointed out, there is a very strong national policy in support of the pension system with the United States and its Treasury standing behind those liabilities in the form of the Pension Benefit Guarantee Corporation. That does not exist with respect to the particular case that we are talking about. Even in ERISA, Senator, it is not a piercing of the corporate veils; it is a liability of the corporation. The corporate integrity is maintained.

The **Chairman**. It is a liability of the corporation because we made it a liability of the corporation, right?

Mr. **Miller**. That is correct, and it has been known to be a liability. People who were extending credit to a holding company knew that there was a potential liability for under-funded pensions.

The **Chairman**. My recollection was we received the same argument that you are giving me now about the credit markets back then about pensions. The same argument was being made, equally as articulate but, nonetheless, being made. Am I correct?

Mr. **Miller**. Well, you are changing. As Senator Specter pointed out, you are changing hundreds of years of corporate law.

The **Chairman**. But we did back then, did we not?

Mr. **Miller**. For a very strong national policy in which the U.S. Treasury stood behind the pension benefits.

The **Chairman**. Now, let us assume that we made similar policy. The Congress made the policy.

Mr. **Miller**. Yes, Congress made the policy, Senator, and prospectively, that was the law. The credit markets would react to that.

The **Chairman**. Right. That is the only point I am making. You make a compelling argument when it stands by itself that, in fact, the credit markets go haywire. But I sat and listened time and time and time and time again to every corporate chief who came down and told me: Boy, if this ERISA gets changed this way, it is just going to be chaos, absolutely chaos. Corporate America is going to crumble. No one will ever get credit. It will not happen. Why would someone come in, as Mr. Seiden suggested, and decide to become involved, in effect, in taking over companies that were not so solid, were not so stable, and had pension liabilities? Why would they do that?

Now, explain to me one other thing, if I may. What difference does it make—and I am sure it does make a difference, but I want to hear it from you. What difference does it make if the Federal Government is guaranteeing the pension liability and not guaranteeing the liabilities that exist if this law were to pass?

Mr. **Miller**. Because in the ERISA situation, Senator, the taxpayers' money is at risk, and the Government, I assume, was very interested in getting back the taxpayers' money.

The taxpayers' money is not at risk in this situation.

The **Chairman**. The taxpayers' safety is at risk, is it not?

Mr. **Miller**. Yes, it is. And the Department of Transportation found that Eastern is a fit air carrier.

Now, if I can go back, if I might, to the situation with ERISA, chaos did not result; but I assure you, Senator, that it is more expensive for a company that has an under-funded past pension liability to borrow money. Take the case of the steel companies. Nobody lends money to a steel company unless it is on a secured basis so they can get ahead of ERISA, or ahead of the PBGC.

The **Chairman**. I have no doubt about that. You are correct.

Mr. **Miller**. That makes a big difference.

The **Chairman**. That is a policy decision, and my policy is to yield.

Senator **Metzenbaum**. I want to make an announcement that was just handed to me. The Chair at the early part of the meeting talked about the ticket holders protecting themselves. I wrote to the Federal Trade Commission the other day urging them to take a public position on this subject. I am pleased to report that as of just this moment the FTC put out a press release saying Eastern Airlines customers with canceled tickets have rights under Federal credit law.

That includes you, Mr. Chairman.

You must take several steps. You must send a written notice to the card issuer, and it must be sent to the address listed on your bill for billing error inquiries. You have to include in the notice certain specific information they mention. You must keep a photocopy of the notice and send the notice by certified mail, return receipt requested. I gather that has to go to the Bankruptcy Court.

There are some other ways that those who are obligated to Eastern have of protecting themselves, and I thought I ought to bring this to your attention.

[The aforementioned material follows:]

JOSEPH R. BIDEN, Jr., DELAWARE, CHAIRMAN

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United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, DC 20510-6275

March 13, 1989

Daniel Oliver
Chairman
Federal Trade Commission
Washington, D.C. 20580

Dear Chairman Oliver:

I request that the Federal Trade Commission initiate immediately a special effort to inform consumers who have purchased a ticket on Eastern Airlines of their rights under the Fair Credit Billing Act. Many consumers, perhaps thousands, have been told that Eastern will not honor their tickets and that they must apply for a refund. As unsecured creditors, these consumers may not be able to recover more than a small fraction of their payment when such a refund, if any, is paid.

As I understand the law, consumers who have purchased a ticket from Eastern with a credit card do not have to pay for it if the ticket is not honored. Under the provisions of the Fair Credit Billing Act, consumers can withhold payment from the credit card company, e.g., MasterCard or Visa, if Eastern does not honor their ticket or provide a comparable substitute such as a ticket on another airline. However, the consumer must notify the credit card issuer in writing within 60 days and explain their reasons for withholding payment. It is essential that the consumer withhold payment in order to take advantage of this right.

In addition, I understand it is advisable that consumers also try to approach Eastern directly and make sure that their ticket is not going to be honored. This step allows them to take advantage of another section of the Fair Credit Billing Act, which provides that a consumer can withhold payment from a credit card issuer if: 1) they have made a good faith effort to obtain the ticket from Eastern; 2) the ticket price exceeds $50; and 3) the place where they bought the ticket is within their state or 100 miles from their home. Again, it is essential that the consumer withhold payment to take advantage of this section of the law. If the consumer writes the credit card issuer directly within 60 days and withholds payment as described above, they should not be affected by these limitations.

Because there are likely to be thousands of passengers affected by Eastern's filing of bankruptcy, it is important that the FTC issue a bulletin explaining how this statute applies to consumers. Credit card billing statements now typically include a cryptic statement of the possibility that consumers do not have to pay for services or products they do not receive. However, this disclosure may be difficult to understand and apply, particularly in this unusual situation of an airline bankruptcy.

Congress enacted the Fair Credit Billing Act to make sure that consumers are not forced to pay for products or services they do not receive. Congress concluded that the burden of pursuing redress against a seller who does not perform an obligation should fall on a credit card issuer, not on the individual consumer. In other words, if Eastern cannot make a refund, the loss should fall on the banks and other institutions which issue credit cards.

Consumers will soon be receiving credit card bills for airline tickets they are not able to use. If they pay the bill, they may never receive a refund for more than a tiny fraction of this amount. Because this area of the law is complex and consumers may not know their rights, the FTC can perform a valuable service by widely publicizing a clear explanation. I urge you to release immediately a bulletin explaining consumers' rights in this situation. This bulletin should be made widely available to the press and released to local television and newspapers throughout the United States. You should also attempt to arrange public service announcements as well.

Thank you for your cooperation. I stand ready to assist you in any way in helping consumers understand their rights in this matter.

Sincerely,

Howard M. Metzenbaum
United States Senator

FTC *Focus*

eral Trade Commission • Office of Public Affairs • Washington, D.C. • 20580 • Tel. (202) 326-2180

EASTERN AIRLINES CUSTOMERS WITH CANCELLED TICKETS HAVE RIGHTS UNDER FEDERAL CREDIT LAW

Consumers holding tickets for cancelled Eastern Airlines flights may be able to protect themselves under the federal Fair Credit Billing Act (FCBA), according to the Federal Trade Commission. If you purchased tickets with a credit card for a flight that was cancelled by the airline, you may be able to use the "billing error" protections of the FCBA to avoid paying for tickets that can't be used.

These are the steps to follow:

-- Send a written notice to the card issuer. It must be sent to the address listed on your bill for billing error inquiries.

-- Include in the notice the following information:

  -- Your name and account number;

  -- A statement that you are withholding payment (or requesting a refund, if you have already paid) because the bill contains a billing error; and

  -- A description of the error, with dollar amount and reference number of the ticket transaction. Example: "Eastern Airlines cancelled my flight, No. XYZ on March xx, 1989, and will not honor my ticket, which appears as Number YYY for $ZZZ on my March bill."

-- Keep a photocopy of the notice and send the notice by certified mail, return receipt requested. Drug stores, libraries and post offices often have photocopy machines you can use.

-- Be sure to mail the notice in time to reach the card issuer within 60 days after the first bill containing the error was mailed to you.

-- Keep the ticket in a safe place. You may be asked at a later date by the card issuer to provide it as evidence that you held a ticket on a cancelled flight.

The credit card issuer has 30 days to acknowledge the dispute in writing, unless the dispute is resolved by that time. At the latest, the dispute must be resolved within two billing cycles or 90 days, whichever is less.

Under the FCBA, if a dispute is resolved in the consumer's favor because a service was not delivered as promised, the credit card issuer must credit the consumer's account.

Even if it's been more than 60 days since the first bill for the tickets was sent, consumers can still send a notice to the card issuer. Consumers who have not yet paid the disputed charge may have other rights under the FCBA.

The FTC has a free brochure that explains consumers' rights under the FCBA. For a copy, write: "Fair Credit Billing," FTC, Division of Credit Practices, Washington, D.C. 20580; or call 202-326-3175.

# # #

MEDIA CONTACT: Office of Public Affairs, 202-326-2180

STAFF CONTACT: Division of Credit Practices, 202-326-3175

(Eastern)

The CHAIRMAN. Mr. Chairman, I do not have any more questions. I have to be on the House side, the House of Representatives. I have questions for the next panel. Would you be kind enough to submit them for me, not necessarily to be answered at this moment but to be answered in writing?

Senator METZENBAUM. Certainly.

The CHAIRMAN. I would like to ask unanimous consent. I have several more questions because I think the testimony of both of you is very informative. I have several additional questions I would like to be able to submit in writing, if I may.

Senator METZENBAUM. Certainly.

I might say to Mr. Miller that when the Senator from Delaware was inquiring of you as to the difference between the protection in pension matters as compared to this proposed law, you seemed to emphasize the great impact on the credit market under the pension law. And Senator Biden pointed out that was raised as a bogey man at that time.

Then when he asked you further, you said, well, there is a difference here because the Government is the creditor. But the fact is from the standpoint of the impact upon the credit market, it would not be one whit difference as far as whether the Government's a creditor or whether the Government is not a creditor. Is that not the case?

Mr. MILLER. No, Senator. With all due respect, it will have an impact on the credit market in terms of how people lend. Would Mr. Pritzger have ever bought Braniff Airlines and put it back up in the air if his entire empire was going to be subjected to potential bankruptcy?

Senator METZENBAUM. He would not have had to buy it through a corporation. He could have bought it individually; then that would have——

Mr. MILLER. That is not the way Americans do business. This terrible looking chart which has been prepared here, this is the way all American business is done.

Senator METZENBAUM. Professor Miller, you are certainly more experienced in bankruptcy law than I am, but certainly the Pritzgers could have bought it in their individual names, or they could have formed a new corporation which would not be affiliated in any way with any of the other corporations.

What we are talking about here are affiliated corporations. We are talking about this total conglomerate.

Mr. MILLER. And if he bought it individually, Senator, he would have personal liability also. And I do not think——

Senator METZENBAUM. What is the authority for that statement?

Mr. MILLER. If he bought it individually and was the sole stockholder, there is also a thing called piercing the corporate veil.

Senator METZENBAUM. Well, no. I mean, assume several members of his family or a group—I mean, you are not talking about one person.

Mr. MILLER. I do not know what the format is that you are suggesting, but that is not the way American business is done.

Senator METZENBAUM. Well, I do not think that you ought to suggest, Professor Miller. You are too good a lawyer and a professor to say to me that had he bought it personally, he would have been liable. That is not the law, and you know it is not the law. So I do not know why you would suggest it.

Mr. MILLER. If he bought it personally, Senator, and it was a sole proprietorship——

Senator METZENBAUM. Well, now you are adding if it is sole proprietorship. That need not be. You are adding a factor that nobody has talked about.

Mr. Seiden, I want to ask you a question. Continental is losing money?

Mr. SEIDEN. Now, Senator?

Senator METZENBAUM. Yes.

Mr. SEIDEN. I do not believe that is so, sir.

Senator METZENBAUM. How much did they lose last year?

Mr. SEIDEN. Continental had a poor year in 1988; it lost in excess of $300 million.

Senator METZENBAUM. How much the year before?

Mr. SEIDEN. I believe the loss in 1987 was approximately $250 million. But that, Senator, really reflects I think the flowing through of the acquisition costs of People's Express and Frontier. Continental, as you know, Senator, absorbed all of the operations of those two companies in late 1986 and 1987. And as of February 1, 1987, that absorption was complete.

That act had the effect of doubling the size of Continental, which was very important, we felt, for Continental in terms of growing and staying on a par with the mega-carriers in this country. But both of those airlines were sick. In the case of People's Express, it was losing $10 to $15 million a month, and toward the end of it, before we bought it, they were up to the $40 million a month range, as I recall.

Of course, Frontier had totally ceased operations in August of 1986 before we bought it, when it was part of the People's Express group.

Senator METZENBAUM. Is People's Express still operating?

Mr. SEIDEN. People's Express's operations have been completely absorbed into Continental. People's Express today is still a corporation for corporate purposes, but all of its operations are conducted under the supervision and control of Continental Airlines. In terms of it operating as an operating airline, the answer is no. But there is an agreement between Continental and People's Express for——

Senator THURMOND. Mr. Chairman, would you yield to me just a minute?

Senator METZENBAUM. I certainly will.

Senator THURMOND. I have some questions here that I am just going to ask that they be answered for the record. Mr. Cheney is on the floor, and I have got some people waiting I have got to see. Gentlemen, we are very pleased to have you all here, and we welcome you here.

Mr. SEIDEN. Thank you, Senator.

Mr. Chairman, what I was getting at was that when those terribly distressed companies that were hemorrhaging money were absorbed into Continental Airlines, the hemorrhaging did not just go away. It was simply transferred on to the books of Continental. It has taken us somewhat longer than we thought it would take to fix those problems. We believe finally now, at last, we have those problems fixed.

Senator **Metzenbaum**. What is the financial position of Jet Air Corp.? What is its net worth?

Mr. **Seiden**. I do not know, Senator.

Senator **Metzenbaum**. Is that not part of your jurisdiction? Are you not the associate general counsel for Texas Air?

Mr. **Seiden**. I am associate general counsel of Texas Air. I have no position with Jet Capital Corporation.

Senator **Metzenbaum**. Can you find that information out for us?

Mr. **Seiden**. What the net worth of Jet Capital is?

Senator **Metzenbaum**. What its assets, liabilities are?

Mr. **Seiden**. I can try to find that out, sir.

Senator **Metzenbaum**. And what its profits and losses are and have been for this year and the last 3 years?

I would also like to know how much cash or net quick cash it has or has available.

Mr. **Seiden**. At Jet Capital, sir?

Senator **Metzenbaum**. Yes.

Let me identify some transactions for you.

The sale of Eastern's reservation system to Texas Air for $100 million, when the Wall Street Journal reported that your own investment bankers valued the system at between 200 million and $320 million, and I had heard some other reports that outside investment advisors had indicated it might be worth as much as $500 million, the fact that the sale was not in cash but rather in a note—and this, I must tell you, just astounds me—bearing interest of only 6½ percent but not payable until the year 2001.

Now, if that isn't insider trading, I don't know what it is.

The sale of 11 gates at Newark Airport to Continental for $1 million per gate, although their value is appraised at twice that amount by an airline consulting firm, Eastern's payment of $22 million to Continental "to provide services in the event of a strike," there are dozens of such transactions, Mr. Seiden.

American people believe, and those of us in the Senate have come to believe that Mr. Lorenzo has charged Eastern millions of dollars in management fees, fuel purchase commissions, equipment rentals, et cetera.

Given this pattern and practice, why shouldn't the entire Lorenzo "House of Mirrors," as it was called by the Wall Street Journal, be thrown into the pots so the thousands of Eastern ticketholders, workers, and other creditors can get what is justly theirs.

Mr. **Seiden**. Senator, I am sure that in your long and illustrious career in the Senate, from time to time your actions have been unjustly criticized in the media. We are no different. From time to time, our dealings are unjustly described and criticized in the media.

That Wall Street Journal article is grotesquely unfair and inaccurate. We have done our very best in every forum in which we have had to confront those inaccuracies to set the record straight. Apparently we have not fully succeeded, although whenever our adversaries are put to the test of seeking to prove the truth of the matter before an impartial trier of fact, they cannot do so.

Senator METZENBAUM. How much did you sell the reservation system for?

Mr. SEIDEN. The reservation system was sold in the manner you have described it, Senator, for a $100 million note.

Senator METZENBAUM. Not payable until 2001?

Mr. SEIDEN. Yes, that is correct.

At the time the transaction took place, the note—and it is still the case—the note was convertible into Texas Air common stock at a price that was determined at that time. The price that was determined at that time was reflective of the price that Texas Air stock was selling at in the market at that time.

That is a normal type of a business transaction so that if Eastern had wished to convert that note into cash, it could have, as I understand it, and this is a securities issue that I am not an expert in, but as I understand it, they would have merely had to retain a law firm to prepare registration statement and then market it and convert it into stock, and then they could have cashed it out.

Senator METZENBAUM. If somebody would be willing to buy a note at 6½ percent payable in the year 2001 with no payment in the interim.

Mr. SEIDEN. No. What I'm saying, Senator, was not to market the note itself which, of course, they could have done. I'm saying that the note has a provision that allows it to be converted into common stock which, of course, then can be sold on the open market.

Senator METZENBAUM. That was a self-dealing matter between an airline controlled by Texas Air, and Texas Air——

Mr. SEIDEN. No, Senator. With all due——

Senator METZENBAUM. And Continental also controlled by Texas Air.

Mr. SEIDEN. I don't think that it's fair and accurate to describe that transaction and other affiliated transactions as self-dealing.

There were two precautions that were taken in Eastern's behalf in respect of that and all of the other transactions to which you've made reference. One of them was that a committee was formed at Eastern of the outside independent members of the Board of Directors of Eastern Airlines, as is required, I believe, under Delaware corporate law where Eastern is incorporated, to review that transaction from the perspective only of Eastern Airlines, to determine whether it was in the best interest of Eastern Airlines. And that independent committee of directors at Eastern did conclude that it was in Eastern's best interest.

Second, Senator, that transaction was reviewed by an independent investment banking house different from the one that you've made reference to in your question. And a statement of fairness was given, both as to the transaction and as to the value of the note.

The discrepancy between the fairness opinion given in respect of the $100 million note and the $200 to $300 million matter that you've made reference to involves fairness opinions as to very, very different transactions.

All throughout 1985 and 1986, before Texas Air obtained control of Eastern Airlines, Eastern was trying to sell its computer reservation system. Eastern had concluded it needed to make an investment of somewhere between $200 to $400 million in System One in order to keep it technologically competitive with the Giant CRS Systems, Sabre at American, and Apollo at United.

Eastern was a carrier in terrible financial distress all throughout 1985 and 1986. It was losing its travel agency base in System One. It was in danger of having this valuable asset disintegrate into nothing if the travel agents started deserting System One. So Eastern was trying to sell it. This was before we came on the scene. They tried to sell it to Piedmont and tried to sell it to U.S. Air, they tried to sell it to Northwest, they tried to sell it to a neutral industry booking system, a conglomerate of 25 airlines that put themselves together at one point to try to form a CRS. It was unable to do that on any of those occasions because Eastern was insisting on the right to retain an equity interest in the CRS so that it could retain the booking advantage from being involved with the CRS.

The $200 to $300 million evaluation placed on System One at that time placed it on the basis that Eastern would not retain any of the booking value, that it would be sold, lock, stock and barrel out of the company, and Eastern would lose all of the so-called halo effect, and that the acquiring company would obtain all of that halo effect.

A CRS system sold that way had a different value than a CRS system told to a Texas Air subsidiary where Eastern retained virtually all of the halo effects. It was a very beneficial transaction to Eastern. No acquiring entity other than the Texas Air subsidiary was willing to buy System One on a basis where Eastern could retain a corporate relationship with it. And that's why the valuation of System One sold the way it was, was fair and reasonable, determined both by the independent Board of Director committee and an independent investment banking house.

Senator **Metzenbaum**. I have difficulties with your answer. I would prefer to be able to inquire further, but my time has expired.

Senator Simon.

Senator **Simon**. If I may follow through on that while it is in this commuter reservation system. And there have been published reports that, along with the sale, Eastern signed a contract to pay out in effect $130 million for the use of that reservation system. Is that correct?

Mr. **Seiden**. Senator, certainly they signed a contract. I can't verify with you today what the amount of it is so I don't know if $130 million is accurate or not.

What happened was Eastern Airlines incurred a lot of costs internally by owning this System One reservation system as a division of the corporation. It had hundreds, if not thousands of employees. It had computer expenses. It had IBM expenses. It was a very expensive kind of system to run, Senator. And as I indicated, Eastern had concluded before we bought them that it had to make investments of between $200 to $400 million, which it did not have, to upgrade it.

When the system was bought from Eastern, Eastern was relieved of all of these costs. And that was a benefit to Eastern. But now Eastern was receiving a service and, of course, would have to pay for the service. And the fees that Eastern pays for the services are, as I recall, cost plus 8 percent, which is really industry standard.

Senator SIMON. In terms of the sales that you talked about before, when Eastern tried to sell their reservation system to others, did Eastern make clear they were willing to sign a contract for $130 million with whoever they were going to sell this reservation system to?

Mr. SEIDEN. Senator, I don't know. This happened before I was there.

Senator SIMON. I would just add that's a fairly significant factor in a sale.

Mr. SEIDEN. Well, the provider of the service to Eastern—in this case, System One Corporation—obviously can't provide a very expensive service to Eastern Airlines for free. System One now employs some 1,400 employees, has made hundreds of millions of dollars—perhaps not that much, but many millions of dollars of investment in upgrading the system which Eastern could not afford to do.

CRS systems are very expensive to maintain and operate. And now Eastern doesn't have to experience the cost of maintaining its own system, but it does have to pay the provider of that system and the services to it sufficient compensation to justify the services being provided.

Senator SIMON. You mentioned the Wall Street Journal article not being accurate.

Do you deny that there has been draining of resources of Eastern to the parent corporations?

Mr. SEIDEN. Yes. Because you use the word "draining." There has been no draining of assets. There have been sales of assets moving in both directions, I might add, and each one of those transactions, each one of them has been reviewed by independent members of the Board of Directors of Eastern as well as we have gotten fairness opinions from independent investment banking houses. And they have all been found to be in Eastern's best interests.

Senator SIMON. I guess one of the real questions is how independent that Board of Directors at Eastern is, how independent anyone is. At least the legend is that one person in fact is making all of the decisions for all these corporations, for Jet Air, for Texas Air, for Eastern, for Continental, for all these corporations.

Mr. SEIDEN. Senator, what I was trying to make clear is that the individuals on Eastern's board who reviewed and signed off on these transactions are the outside independent members of the board.

Senator SIMON. They are outside independent members but could they be removed practically by Frank Lorenzo if he wanted to remove them?

Mr. SEIDEN. Texas Air, as the owner of 100 percent of the common stock of Eastern Airlines, has the legal right to put people on the board.

Senator SIMON. And Texas Air, 34 percent of that is owned by Jet Air, is that correct?

Mr. SEIDEN. Jet Capital. I'm not sure of the exact percentage, but it's approximately, yes, sir.

Senator SIMON. OK. And who controls Jet Capital?

Mr. SEIDEN. Mr. Lorenzo is influential at Jet Capital.

Senator SIMON. I think that's a modest statement. [Laughter.]

Mr. SEIDEN. Whether he has control of Jet Capital in some legal sense and some securities sense, I'm not prepared to confirm or deny.

Senator SIMON. I think most of us can make conclusions on that one.

Let me shift to another example. Is it true that Eastern paid $1.5 million to acquire a small commuter airline?

Mr. SEIDEN. I think you're referring to the Bar Harbor transaction, Senator. And if I may, I would like to take an opportunity to explain that transaction to you.

Bar Harbor is a commuter airline. It historically was one of the airlines that Eastern depended on to provide it with feed. There came a point in time when it was in Eastern's interest to acquire Bar Harbor, but that it was not possible for Eastern to do that for a variety of financing and other reasons so that Eastern couldn't accomplish the transaction that it felt it needed to accomplish.

As an alternative to that, Continental Airlines acquired Bar Harbor, but for the benefit of Eastern Airlines, and Eastern Airlines then compensated Continental for that in a variety of ways.

That's the sum total of that transaction, Senator.

Senator SIMON. What was the cost of that transaction? What did it cost Eastern to acquire that?

Mr. SEIDEN. I'm not certain of that right now.

Senator SIMON. But, to your knowledge, is the figure of $1.5 million used in the press accurate?

Mr. SEIDEN. Senator, that transaction——

Senator SIMON. As far as you know, that figure of $1.5 million used in the press is not inaccurate?

Mr. SEIDEN. That transaction is one of a number of transactions that was described in detail by the Secretary of Transportation in his report of last year. There is a specific appendix in his report that sets out the detail that you're seeking to capture with me.

I have that report with me. If you want, I can open up that appendix and give you an answer.

Senator SIMON. I appreciate that. But, as far as you know, the published reports are not inaccurate?

Mr. SEIDEN. The published—the DOT report is accurate. I won't vouch for the Wall Street Journal but I will vouch for——

Senator METZENBAUM. I gather that the Senator from Illinois is asking about the statement that was in the Wall Street Journal, which said that when Continental bought 50 percent of Bar Harbor Airways, a commuter that feeds passengers to Eastern, an apparently grateful Eastern paid Continental a fee of $1 million although the whole sale was worth only $1.5 million.

You know, that kind of thing unanswered, telling us to read some other report, smacks of hanky-panky. It smacks of milking Eastern for the benefit of other Lorenzo airlines. And that's the difficulty that this committee is having with this entire issue.

Mr. MILLER. Senator, all of those transactions, by reason of the fact of the filing of the bankruptcy petition, will now be reviewed in the bankruptcy court.

Senator **Metzenbaum**. By whom? There will be no trustee.

Mr. **Miller**. That is not correct, Senator.

Senator **Metzenbaum**. Well, who is going to do it?

Mr. **Miller**. The company itself has asked for the appointment of an examiner, which is a statutory entity created in the Bankruptcy Reform Act of 1978, whose function it is to investigate and determine whether there are causes of action.

If there has been a fraudulent transfer or a fraudulent conveyance, and you didn't have to wait till bankruptcy to do that, any creditor could have brought a fraudulent conveyance or a fraudulent transfer action if it saw fit.

But the company has specifically asked that everyone of these transactions be reviewed by an independent body.

Senator **Simon**. But, Mr. Miller, you know and I know that fraud is a very difficult thing to prove.

Mr. **Miller**. Not fraud in a civil sense, sir, with all due respect.

Senator **Simon**. But even then. And what we're trying to get at is did Eastern in fact pay a $1 million fee for advice on a $1.5 million transaction?

Mr. **Miller**. And the issue will be, Senator, whether or not that was an adequate or inadequate consideration. And if it was inadequate, the Bankruptcy Code provides a means to recover that money.

Senator **Metzenbaum**. Well, whether it was adequate or inadequate, it seems to me it was certainly a generous contribution on the part of Eastern. I think there are a few people in the audience who would love to get that kind of a fee for advising on a $1.5 million——

Mr. **Miller**. But I think when all the facts are spread across the record, Senator, you may come to a different conclusion.

Mr. **Seiden**. Senator, I don't think you'll find that the $1.5 million fee was for advice as you put it. It was for the commercial benefits that Eastern expected to get from a continuation of the feed traffic.

Senator **Simon**. Well, we come up to the situation where, time and time again, we are told, the published reports are not accurate.

What about the one you did not answer when Senator Metzenbaum asked you about the sale of the slots at Newark? You sold slots there, and I forget the figures.

Senator **Metzenbaum**. $11 million, $1 million a slot. It was reported to be worth at least $2 million a slot. They sold a lesser number of slots in North Carolina to Piedmont Airlines I think for $25 million.

Senator **Simon**. At Charlotte, NC.

Senator **Metzenbaum**. Charlotte, NC.

Mr. **Seiden**. Senator, I think that you're referring to the gates actually, not slots. Slots are a term of art. But I understand the transaction as making reference to it.

Senator **Metzenbaum**. I accept the correction.

Mr. **Seiden**. The transaction, as best I can recall it, went something like this: Eastern had excess gates at Newark, substantial amount of excess gates at Newark because People's Express had basically driven Eastern out of Newark by its price cutting in the early 1980's. And Eastern had a lot of gates that were sitting there not being used.

Continental was expanding its position at Newark and had the need for gates. Continental had five gates as I recall. They were really old New York Air gates, and Eastern had 16. They swapped out five for five and left a net 11 going to Continental. And for those 11 net gates, Continental paid $1 million a gate.

That price, as I recall, Senator, was based on a price that had been paid the previous year in the market by New York Air to Pan American, for gates at Newark, $1 million dollars a gate. And so when it came time to do the internal transaction between the two affiliates, Continental and Eastern, they reached back to the most recent gate transaction in Newark about which they were aware and had that serve as the price between them. A fairness opinion was given in those circumstances, and it was found to be a reasonable price.

In juxtaposition to that transaction, Senator, is the transaction at Charlotte to which you make reference. Eastern felt that it had to exit the Charlotte market because of intense competition from Piedmont and because it ought to go back to its roots at Atlanta and concentrate all of its resources at Atlanta.

Piedmont, Senator, at the time, was in an expansion mode at Charlotte, and had been in discussions with the airport operator at Charlotte, with a view toward building new gates to accommodate its increased demand and its needs. These new gates were going to cost Piedmont a substantial amount of money, as I recall, in the range of $3 to $5 million a gate.

And so Eastern found itself in the happy position of having some negotiating leverage with Piedmont to extract a higher price than it otherwise could have gotten that was still less than it would cost Piedmont to build new gates.

And so, in that position, it used that leverage and extracted a premium for the gates at Charlotte. Eastern was in no such position at Newark. There was a tremendous amount of excess capacity at Newark at the time of that gate sale, and the transaction, therefore, was done for $1 million a gate, which reflected a transaction that was done just a year earlier between two wholly-independent companies, New York Air and Pan American.

That transaction too, Senator, has been reviewed by the courts. It's been reviewed by outside investment bankers; it's been reviewed by the independent members of the board, and is going to be reviewed by the examiner in Judge Lifland's court. And we are confident that Judge Lifland, the examiner will conclude, as have the previous independent triers of fact, that this was a fair transaction.

Senator SIMON [presiding]. I have to say I am amused by your frequent reference to the independent members of the board, all of whom serve at the whim and the wish of Frank Lorenzo.

Mr. SEIDEN. These gentlemen have fiduciary obligations, Senator, to Eastern. And I don't believe they take their obligations lightly. I don't think they should either.

Senator SIMON. I understand they take their responsibility. I have a staff member right here, Judy White. She's a very fine staff member. She takes her responsibility seriously.

Mr. SEIDEN. If she worked for Eastern, she'd take them more seriously. [Laughter.]

Senator SIMON. Well, if suddenly she decides to disagree publicly with Paul Simon, I think it is at least a remote possibility her job might be in jeopardy.

Mr. MILLER. Would she have personal liability to creditors? The directors will.

Senator SIMON. I understand there is some technical difference and——

Mr. MILLER. Financial. Financial.

Senator SIMON. But the differences are not as great as you would suggest.

Let me just add, you mentioned the Department of Transportation. Let me read from the Department of Transportation report. I'm talking about the Newark gate transactions.

In March 1987, Avmark, an airline consulting firm, appraised the Newark gates at $2.05 million each, and that Avmark's appraisal indicated that Eastern itself had placed a value of 1.875 million for each gate. This is from the DOT Fitness Report, May 25, 1988, Appendix 330, page 1 of 2.

Mr. SEIDEN. I'm aware of those facts, Senator, and all I can say is that when we finally got down to doing the transaction, we concluded, on the basis of the facts that I've given you, that a million dollars was the right price. That was the price that was paid.

Senator SIMON. Let me shift, and this is moving away just a little bit from the legislation at hand.

But, in general, this Nation has moved toward better labor-management relations. I saw the picture the other day of Lee Iacocca handing a profit sharing check to a member of the United Automobile Workers.

I have the impression that there has been no attempt on the part of the management of this complex, whatever you want to call that complex, to maintain good labor-management relations.

Is that an inaccurate impression?

Mr. SEIDEN. Yes, sir, it is an inaccurate impression, unfortunate and inaccurate.

One of the most heartening aspects of the DOT fitness investigation, Senator, which was quite traumatic for all of us, I can assure you, was what the Department of Transportation found to exist at Continental Airlines. And you will find it in the report in great detail about all of the very enlightened and very positive programs that have been implemented at Continental Airlines to maintain very healthy open channels of communication between the employees and management.

There are CEO forum meetings that occur frequently throughout the year. Every officer at Continental Airlines is required to and does adopt a station, and must be out there at the station to meet with the employees frequently.

I could go on and on and on about the many programs at Continental Airlines that exist today, that have worked and are working, including profit sharing, gain sharing and the like, which make Continental a very special place to work in spite of all the trauma that it's been through. In fact, the fact that its employees could carry through what happened to Continental in 1987 and

1988 is a remarkable testament to their drive and dedication. And there are 32,000 of them today, Senator. And people don't speak very much about what they do every day. But it is truly remarkable what they do.

We have profit sharing at Continental. And until the People Express trauma of 1987 and 1988, the employees of Continental received substantial amounts of profit sharing checks. That was in 1985 and 1986.

And so I don't feel that it is an accurate statement to say that the management of Texas Air is unmindful of the need to treat human beings that work at the companies in a fair and equitable and positive way. We've tried very hard at Continental to do that. We tried to do some of those things in Eastern too.

When we got to Eastern, we found an absolutely incredible poisonous atmosphere that had been in existence for many years. If you look at my prepared remarks, Senator, and I can tell you when I drafted this, to read it again I was shocked, and I'm shocked when I think about this stuff. But let me just read to you what Colonel Borman had to put up with. I honestly do consider Colonel Frank Borman an American hero. In addition to that, he's a fine and decent man. And if you've met him, I'm sure you'll agree, Senator.

But this is what was said about Colonel Borman by Charlie Bryan at the IAM 12 days after he took over District 100 in January of 1980.

He said, "We continue to act in a professional and responsible manner in spite of the fact that Eastern has resorted to illegal gangsterism in their labor relations policy. The Gestapo tactics of Martin Ludwig Borman and his Nazi torched earth policy will not work with this union leadership."

And I find that outrageous and offensive to compare Colonel Borman to one of the worst villains who ever walked the face of the earth. And when you throw that venom around at a company, Senator, year after year after year, it has an effect, it wears people down, and it dehumanizes the people who you're criticizing. And that's what's happened at Eastern, and that was in 1980, long before Frank Lorenzo ever came on the scene.

And I submit to you the only things that changed at Eastern is the surname of the Frank who is the object of this vilification. Because that's what happened.

Senator SIMON. First, Colonel Borman. I do know him. Don't know him well. He's an alumnus of Illinois Wesleyan University in my State.

I am sure I could find some statement from management that went far too far. But I don't think that's the question.

I have the impression that in the case of Continental, that it has been a union busting kind of operation that has depressed the wages of the people in Continental. What kind of relationship do you have with the unions at Continental?

Mr. SEIDEN. We have one union at Continental, the TWU—no, it's not TWU. It's a union that represents our flight attendants. Otherwise, Continental is not unionized.

It's not from want of trying by some of the unions. ALPA has been trying to organize Continental's pilots, and the IAM has been trying to organize Continental's mechanics. And thus far they have been unsuccessful in that.

Now, the employees of Continental Airlines have an absolute right under our law to make that choice. They have the right to be represented by a union, and have a right not to be represented by a union. And, in spite of all the trauma that's affected Continental and the unions' very determined efforts to obtain representation of the Continental employees, they haven't been able to do so. And I think that says a lot about the attitudes of the employees at Continental Airline.

They still have that choice and they can make that decision any time they wish to, if they wish to be represented by unions, but the unions weren't busted by Continental Airlines management. The unions have not been able to persuade the employees that being part of their organization is in their interest. As soon as they can do that, then there will be unions at Continental in the pilots ranks and mechanics 'ranks. Until they can persuade the rank and file that it is in their interest, there won't be unions.

Senator SIMON. I have a chart that someone has given me showing the average annual labor costs per employee for Delta, Pan American, USAir, Northwestern, United, Eastern, American, TWA, Piedmont and Continental, and it indicates that Continental substantially at the bottom.

Is that accurate or is that not accurate?

Mr. SEIDEN. It is probably accurate. We have been the lowest cost operator in the United States for the last couple of years. Our costs have been increasing on the labor side. We just recently gave our pilots a fairly significant pay increase. Last year, we gave our mechanics a fairly significant pay increase. Our cost advantage on the labor front has been eroding as we pay market wages to those two groups.

Senator SIMON. Getting back to the bill at hand, your position is that the bankruptcy court should not have the ability to look at all the corporations here that are involved. Is that correct?

Mr. SEIDEN. No, that is not our position. Our position is the bankruptcy court should and does have the ability to look at all of these corporations to determine whether there have been improper transactions between them and, if there have been improper transactions, to make rulings in favor of the estate to restore any impropriety.

Beyond that basic fact, which we fully subscribe to and endorse, we think it would be most dangerous, without any proof—because, obviously, if the examiner and the bankruptcy court feel and conclude there have not been fraudulent conveyances, then what would be the basis of subjecting Continental Airlines and its ticket holders and its customers to a bankruptcy, Texas Air Corporation and its public shareholders and debt holders to a bankruptcy, and all of the creditors of these three corporations to the demands of debtors at all of the others?

It is really a rather extraordinary piece of legislation, Senator.

To reiterate, we do not take the position that it is inappropriate for inquiry to be made by appropriate impartial judges into the bona fides of these transactions. We would take the position that it is appropriate for that to happen. We have led the way in petition-ing for the appointment of an examiner. That process should be allowed to go on in an orderly fashion. We believe that all of the allegations that have been made in this committee room this morning, to the media, and in the courts will get a full and fair airing. And if I am wrong in my description of the fairness of these transactions to you, the bankruptcy court will protect the interest of Eastern Airlines and order restoration.

Senator SIMON. But basically you do not want the assets of the controlling corporation to be available to the creditors.

Mr. SEIDEN. Absolutely not. Not unless there is proven to be cause for that to happen.

Mr. MILLER. How about the creditors of those corporations, Senator? How about the public stockholders who bought Texas Air stock on the New York Stock Exchange?

Senator SIMON. I think the answer is, when I buy stock in a corporation, I take a risk. And I know that. But I do not think that stockholders get preference over creditors in these cases.

Mr. MILLER. They do not. But when I buy a public debenture in the stock market or from a broker, I rely upon the credit of that corporation and the corporate integrity of that corporation. What this bill does is it convicts with a trial.

Senator SIMON. I do not think that is an accurate description. But we thank both of you for your testimony here, Mr. Seiden and Mr. Miller.

We would like to call now on the panel of Mr. Theodore Eisenberg, Mr. Farrell Kupersmith, Mr. Charles Tatelbaum, the Hon. William E. Anderson, and Mr. L.E. Creel III.

Our first witness is Mr. Theodore Eisenberg, Professor of Law at Cornell University Law School. We are very happy to have you here, Mr. Eisenberg.

Let me do this, because this is a vote I do not want to miss. Senator Metzenbaum is on the way over there. We will just be in recess maybe for 2 or 3 minutes at the most. He should be here very shortly. So save your words of wisdom here.

[Recess.]

Senator METZENBAUM [presiding]. At this point, I wish to state that Senator Kennedy, has been on the floor addressing himself to the entire subject of the need for an emergency board in connection with the Eastern strike.

Gentlemen, we are very happy to have all of you with us this morning. Having said that, to let you know how grateful I am, let me ask you to limit your comments to 5 minutes. But that is not unusual because we do that quite generally.

I think Professor Eisenberg is first. We will be glad to hear from you.

STATEMENT OF A PANEL CONSISTING OF THEODORE EISENBERG, PROFESSOR OF LAW, CORNELL UNIVERSITY LAW SCHOOL, ITHACA, NY; FARRELL P. KUPERSMITH, ASSOCIATE MANAGING PARTNER OF TOUCHE, ROSS & CO., NEW YORK, NY; WILLIAM E. ANDERSON, U.S. BANKRUPTCY JUDGE, WESTERN DISTRICT OF VIRGINIA, LYNCHBURG, VA, ON BEHALF OF THE NATIONAL CONFERENCE OF BANKRUPTCY JUDGES; L. E. CREEL III OF CREEL, ATWOOD & PHILLIPS, P.C., DALLAS, TX, ON BEHALF OF THE AMERICAN BANKRUPTCY INSTITUTE; AND CHARLES M. TATELBAUM OF KASS, HODGES & MASSARI, TAMPA, FL, ON BEHALF OF THE AMERICAN BANKRUPTCY INSTITUTE

Mr. EISENBERG. Thank you. I will try in my remarks to perhaps respond to some of the things stated in the previous panels that raised concerns of various members of the committee.

One starting point, I think it is important to separate out the two very different features of the bill. One is the one that effectively subjects labor relations in airline bankruptcies to the Railway Labor Act. On that one, I did not hear much opposition nor comment from Texas Air, and I guess I would support the position of the pilots union which basically says this is a housekeeping measure; that you have airlines and railroads subject to the Railway Labor Act outside of bankruptcy. It makes relatively little sense to subject only one of them to the Railway Labor Act inside of bankruptcy. Indeed, by doing so, you give corporations dealing with airline unions an incentive to seek bankruptcy to the extent existing bankruptcy law is less protective of laborers than is the Railway Labor Act.

With respect to the other part of the bill, which strikes me as more controversial, I guess one thing worth noting is: Senator Biden suggested that Mr. Lorenzo had discovered a new way to do business. If you believe—and I really have to remain agnostic on whether there have been abuses or not—but if you do believe there have been abuses of corporate structure through intercorporate transfers, service fees and the like, Mr. Lorenzo has not discovered anything new. He has gone back to one of the oldest corporate games in American financial history—a game that Congress visited quite a while ago in the Public Utility Holding Companies Act which, as you will see in my testimony, was the subject of congressional concern a while ago, in which they concluded that these complex corporate structures were leading to quite clear abuses. Congress acted in a way that I am sure was described as Draconian then. That is, basically Congress sought to break up the public utility holding companies. They did not limit it to a bankruptcy setting. They simply broke them up.

This type of intercorporate transfer or suspicious intercorporate transfer has been with us before; it is with us now; it will be with us again. And it may be that only Congress has the power to combat it.

One other matter mentioned was the existing remedies in bankruptcy law to deal with allegedly questionable corporate transactions between the Texas Air Corporations. The fact is that it is an enormous burden and quite difficult to prove a fraudulent conveyance attack on a major corporate transactions. Indeed, if Eastern can prove solvency at the time of any of these questioned transactions, fraudulent conveyance law will basically do no good and simply will not provide a remedy outside of bankruptcy or in bankruptcy to undo the transactions.

It takes a very determined person to make a fraudulent conveyance attack on a series of complex corporate transactions. One case I recall is when the United States—it takes almost the resources of the United States to pursue these things as long as they may be necessary against a major corporation.

Mr. Specter was concerned, and I think it is a fair question, about how revolutionary is the part of S. 544 that consolidates, substantively consolidates, all airlines in a control group in bankruptcy. In one respect, it is revolutionary; that is, it does formally dissolve corporate lines in bankruptcy. But given existing bankruptcy and nonbankruptcy debtor/creditor law, if there have been questionable transactions, there is an array of doctrines, fraudulent conveyance law, State law, alter-ego doctrine that was mentioned, that enable creditors to chase questionable transactions. The question is: How effective are those doctrines?

I suggest that if you read a series of cases or lots of cases in recent years making alter-ego attacks, you will find that it is not a very effective doctrine when the people engaging in the transactions are careful to construct the proper paper trail. If they honor the corporate form, if they have the board meetings separate, if they do all the minutes correctly, it is very difficult for a court to say that one corporation has become the alter ego of another.

It is not that it would be impossible to reach questionable transactions under these doctrines. It is simply the case that it is very difficult, and going in, no one can know for sure that it will happen.

One thing S. 544 does, it seems to me, is reverse the normal presumption that says we assume that when corporations deal with each other and they are commonly owned, that they are all benefiting from these transactions. Indeed, their creditors and public debenture holders are benefiting from these transactions; and that it is only fair, once things go bad, that those same people suffer the detriments of the transactions.

I would add to the bill protection for creditors of, say, the parent in this case, if you are taking the structure of Texas Air as an example. I would add a protection. If they can show that they did not benefit from a questionable intercorporate transfer, let them come in and prove it and let them have a priority in the bankruptcy insofar as they did not benefit from the questionable transfer.

With that addition, S. 544 simply reverses in a way the burden of proof in dealing with these questionable transactions. Rather than put all the burden on the victim of the questionable transaction, it shifts it a little bit to people who might have benefited from the questionable transaction.

In that sense, I do not think it is revolutionary. Everyone agrees that if the transactions are questionable they should be undone. The difficulty is how easy is it to prove it when all the books and records are available to the person whose behavior you are challenging.

One other item mentioned by Texas Air's testimony was that the statute is probably unconstitutional because of its—well, it is not retroactive, but because of its near retroactive effect. I guess I would like to see the case for that, since the thrust of the comments suggested that this would be an ex post facto law. In general constitutional law, ex post facto doctrine is limited to punishments; that is, disabilities imposed on criminals or in the criminal law area. I do not think that reshuffling the order of priority in bankruptcy would count as a criminal punishment for purposes of ex post facto law.

Thank you.

[The prepared statement of Mr. Eisenberg follows:]

HEARINGS ON S. 544
Bankruptcy Code Amendments

Senate Committee on the Judiciary
101st Cong., 1st Sess.

Prepared Testimony of
Professor Theodore Eisenberg

Cornell Law School

March 17, 1989

I am a Professor of Law at Cornell Law School. Since practicing law in New York City, I have taught bankruptcy law for more than ten years at UCLA, Cornell, Harvard (as a visiting professor), and Stanford (visiting) law schools and am the author of a casebook and several articles on bankruptcy law. I am also Editor-in-Chief of a ten-volume treatise on Debtor-Creditor Law (including bankruptcy) published by Matthew Bender. A resume containing more detailed information about my background is attached to this statement.

The bankruptcy law amendments proposed in S.544 have two major features. Sections 2 and 3 of S.544 apply Railway Labor Act standards to airlines in bankruptcy just as those standards apply to railroads in bankruptcy. Section 4(2) of S.544 prevents airlines from using Chapter 11 unless every member of an airline's controlled group simultaneously becomes a debtor under Chapter 11. I will comment on the two major features separately.

I. Applying Railway Labor Act Standards

In the Railway Labor Act, Congress made the policy decision that railway laborers should be treated differently than other laborers. That decision was applied to railroads in bankruptcy reorganization via enactment of § 1167. Railroads and their workers received special treatment because their jobs pertained to a segment of the transportation industry vitally affected with the public interest. Disruptive management/labor disputes were viewed as having an adverse affect not only on railroad workers and employers but on the economy as a whole. These adverse affects would not disappear in bankruptcy. When it became commonplace for railroads to operate under the umbrella of a bankruptcy reorganization, Congress decided to apply the Railway Labor Act protections in bankruptcy as well.

The parallel to the airline industry is striking. For many travelers and shippers airlines have replaced railroads as the primary source of transportation. Strikes against major air carriers can have a substantial effect on the public and possibly on the economy. The Railway Labor Act applies to airlines. Now that it is no longer unusual for major airlines to file for bankruptcy it seems appropriate to extend the Railway Labor Act's protection to the bankruptcy reorganization setting. This provision strikes me largely as a matter of housekeeping. To the extent the Railway Labor Act supplies airline workers with greater protection outside of bankruptcy than they currently receive (absent enactment of S.544) inside of bankruptcy, the legal system encourages airlines concerned about labor costs to file for bankruptcy. Unless Congress is willing to repeal the Railway Labor Act's applicability to airlines outside of bankruptcy, or wishes to ignore the reality of the spate of major airline bankruptcies, the extension of Railway Labor Act protections to bankruptcy seems a prudent step.

II. The Simultaneous Bankruptcy Requirement

I understand that the second major feature of S.544, its requirement of a simultaneous bankruptcy filing for commonly owned airlines, responds to possible perceived abuses of commonly controlled airline corporations. Such abuses include, inter alia, questionable intercorporate transfers and service fees. If policymakers believe such abuses exist, the following considerations may assist in assessing S.544. They suggest that there is historical legislative precedent for taking substantial

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action against abuses of corporate structures, that existing bankruptcy remedies probably are insufficient to deal with the particular kind of abuse said to be afoot, and that the proposed measure can be defended as a matter of public policy.

A. Historical Precedent: The Public Utility Holding Act

This is by no means the first time, and probably will not be the last time, that Congress concerns itself with the effect of corporate structures, holding companies, and questionable intercorporate transactions on the public good. Over fifty years ago, in the Public Utility Holding Company Act, Congress sought to disperse ownership and control of the nation's gas and electric utilities. Concentration was part of the problem but the ability to manufacture intercorporate transactions was a central focus of congressional concern.

> Some [holding-company magnates] bent their efforts to the accumulation of voting control over existing utilities and other enterprises, deprived them of all semblance of independence, and smothered them under elaborate paper superstructures. The operating utilities and other businesses at the base of these pyramids furnished all the revenues derived from outside sources, and a large percentage of revenues were drained off, in numerous instances, by exorbitant service and construction fees charged against them by 'service companies' belonging to the parent holding company or to the individual interests who control the system. . . . In such systems the companies in the superstructure were used for the purpose of retaining the insiders' control while the financial investment and risk were passed on to public investors by the floatation of a myriad of holding-company securities carrying no effective power to control the management.[1]

Congress responded by effectively requiring the breaking up of the holding companies and by 1952 more than 750 holding companies had been dissolved. The

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[1] Blair-Smith & Helfenstein, A Death Sentence or a New Lease on Life? A Survey of Corporate Adjustments under the Public Utility Holding Company Act, 94 U. Pa. L. Rev. 148, 150-51 (1946). The authors note that:

> The functions of the system-owned and affiliated "service companies" varied widely. Some furnished engineering advice and construction work, some furnished bookkeeping or auditing services, some performed outright every managerial function that an operating company's officers and board of directors could have performed. Whatever they did, the purpose of many of them was to obtain fees (including profits often running to 100% or more) which would be treated as operating expenses or capital costs in the accounts of the paying utilities, but would be received as income by the controlling companies. Since the companies paying the fees were under the control of the very persons who profited from the fees, the system-owned or affiliated service company was in a position to render "services" (whether they were needed or not) at prices which were not limited by competitive conditions or even by the independent business judgment of the paying company's officers.

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Supreme Court sustained the legislation.[2] The difficulty of efficiently policing intercorporate transactions played a major role in Congress's deliberations.

B. Other Bankruptcy Remedies

Other available means for dealing with questionable intercorporate transactions are unlikely to suffice. Among the available weapons in bankruptcy are (1) substantive consolidation of bankruptcy proceedings of related companies, (2) equitable subordination, (3) fraudulent conveyance doctrine, (4) preference doctrine, and (5) piercing the corporate veil under existing bankruptcy law. None of the existing doctrines provide reasonable assurance that questionable intercorporate transfers could be recovered.

1. Substantive Consolidation. Generally, substantive consolidation consolidates in one bankruptcy proceeding the separate bankruptcy proceedings of two or more corporations already in bankruptcy.[3] Substantive consolidation usually results in pooling the assets of, and claims against, the two entities; satisfying liabilities from the resulting common fund; eliminating inter-company claims; and combining the creditors of the two companies for purposes of voting on reorganization plans. 5 Collier on Bankruptcy § 1100.06, at 1100-32 n.1 (L. King ed. 15th ed. 1988). The goal of consolidation, which is to achieve fairness to creditors, and the factors used to decide whether to consolidate are similar to the goals and factors one would use in deciding whether it is appropriate to reach the assets of a nonbankrupt corporation that is related to a corporation in bankruptcy. But the fact remains that consolidation is not commonly used to bring into bankruptcy a parent or related corporation that has not already filed a bankruptcy petition.

2. Equitable Subordination. Under § 510(c) of the Bankruptcy Code, which stems from judicial interpretation of prior bankruptcy law, a company related to a bankrupt debtor may be placed behind other creditors in collecting from the bankrupt's estate. Similarly, the related nonbankrupt company's shareholder interests in the bankruptcy debtor may be subordinated to the interests of other shareholders.

There are two significant problems with relying on the doctrine of equitable subordination to deal with massive questionable intercompany transfers. First, the doctrine does not go so far as to allow recovery of amounts actually transferred to the nonbankrupt related company. It merely subordinates the related company's claims against the debtor to other interests. If the related company already has received substantial value from the debtor, equitable subordination doctrine is unlikely to be useful. Second, the requirements for invocation of the doctrine are murky. Aside from general notions that the company related to the debtor must have behaved inequitably, it frequently is not clear what divides the cases allowing and disallowing equitable subordination.[4]

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[2] American Power & Light Co. v. SEC, 329 U.S. 90 (1946); North American Co. v. SEC, 327 U.S. 686 (1946); Electric Bond & Share Co. v. SEC, 303 U.S. 419 (1938). Somewhat different concerns about the corporate structure of the banking industry led to enactment of the Bank Holding Company Act of 1956.

[3] E.g., In re Augie/Restivo Baking Co., Ltd., 860 F.2d 515 (2d Cir. 1988).

3. Fraudulent Conveyance Doctrine. Sections 544(b) and 548 of the Bankruptcy Code allow bankruptcy trustees and debtors-in-possession to recover for the benefit of the estate transfers that are vulnerable under principles of fraudulent conveyance law. Fraudulent conveyance doctrine has been increasingly relied on in recent years to attack leveraged buyouts and other sophisticated corporate transactions when the debtor winds up in bankruptcy.[5] In one respect, fraudulent conveyance doctrine is well-suited to dealing with tainted intercorporate transfers. It allows the debtor or trustee to pursue assets in the hands of the transferee. Thus, unlike equitable subordination doctrine, fraudulent conveyance doctrine is not limited merely to subordinating a connected corporation's debt or equity claims to the claims of other interested parties.

In other respects, however, fraudulent conveyance doctrine is likely to fall short in dealing with massive, possibly unfair, intercorporate transfers. First, the doctrine requires that a specific transaction be the subject of attack. An overall, complex pattern of dealing may be beyond the doctrine's reach or too costly to establish. Indeed, one commentator explains the existence of equitable subordination doctrine as a partial reaction to the inability of fraudulent conveyance doctrine to reach complex transactions.[6] Second, unless one can establish that a transfer was made with actual intent to hinder creditors, a difficult evidentiary hurdle, a fraudulent conveyance attack requires that the debtor be in financial difficulty at the time of the challenged transfer or that the transfer place the debtor in such difficulty. It thus is a defense to most fraudulent conveyance attacks that the debtor was solvent at the time of the transfer.[7] In particular, fraudulent conveyance doctrine allows solvent debtors to give away or otherwise waste assets so long as they do not cross the magic line between solvency and insolvency. Public shareholder equity and debtholder cushions are not well protected by fraudulent conveyance doctrine.

4. Preference Doctrine. Like fraudulent conveyance doctrine, bankruptcy preference doctrine requires an attack on a specific transaction and cannot be based on an entire course of dealing. It thus may be costly to try and disentangle the many transactions between related corporations. Furthermore, preference law requires that the value transferred be paid on account of an antecedent debt and not be paid in the ordinary course of business. 11 U.S.C. § 547(b)(2), (c)(2). Thus, if payments to related corporations are made in a timely manner, and not simply on the eve of bankruptcy for old unpaid debts, it will prove difficult, if not impossible, to mount a successful preference attack. Even if payments are made on account of antecedent debts, preference law requires that they be made while the debtor is insolvent. 11 U.S.C. § 547(b)(3). As in the case of fraudulent conveyance doctrine, preference doctrine allows complete diminution of a corporation's equity cushion before threatening to unwind transactions.

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[4] Compare, e.g., Taylor v. Standard Gas & Elec. Co. (Deep Rock), 306 U.S. 307 (1939) (requiring subordination) with Comstock v. Group of Institutional Investors, 335 U.S. 211 (1948) (5-4 decision not requiring subordination).

[5] E.g., United States v. Tabor Court Realty Corp., 803 F.2d 1288 (3d Cir. 1986); Telefest, Inc. v. VU-TV, Inc., 591 F. Supp. 1368 (D.N.J. 1984).

[6] Clark, The Duties of the Corporate Debtor to Its Creditors, 90 Harvard L. Rev. 505, 530-31 (1977).

[7] See Telefest, Inc. v. VU-TV, Inc., 591 F. Supp. 1368 (D.N.J. 1984).

5. Piercing the Corporate Veil under Current Bankruptcy Law. There are a few examples of bankruptcy courts piercing the corporate veil in the context of a bankruptcy proceeding,[8] but it is relatively rare. The basic problem is the same that arises in trying to pierce the corporate veil outside of bankruptcy. If those controlling the corporation honor the corporate form it usually is difficult to convince courts to pierce the veil.[9] As in the Public Utility Holding Company Act era, the problems facing Congress now have more to do with the substance of intercorporate transactions. It may be that related airline companies dutifully observe corporate formalities. Even if formalities are honored, there remains the question whether one corporation has unduly exploited others. If it has, existing veil-piercing doctrine cannot be relied on to resolve the problem.

C. The Solution Contained in S.544

1. The Common Bankruptcy. The merits of S.544's treatment of airline control groups depends largely on a factual determination. If the airline industry is troubled by questionable intercorporate transfers, existing bankruptcy doctrine cannot assure that creditors, employees, and the public receive a fair chance to challenge and recover those transfers. Intercorporate transfers can only be recouped by going after the beneficiary of the transfer. The costs of pursuing the beneficiary under existing law are high and the outcome uncertain. Many interested parties will choose not to do so.

Given existing circumstances, the proposed legislation can be viewed as engaging in the assumption that subsidiaries in commonly controlled airline corporate groups have been operated for the benefit of the group as a whole or the group's parent, and not solely for the benefit of each subsidiary and its shareholders and creditors. To the extent that the group as a whole and the parent (and the group's and parent's creditors and stockholders) benefit from such relationships with subsidiaries, it is not unfair to have them share in the burden of a subsidiary's financial distress. That is what S.544 does.

Some creditors dealing with the parent or sister company of a bankrupt subsidiary might object that they dealt with one company as a credit risk and now find themselves having to suffer the loss resulting from a subsidiary's financial difficulty. Such creditors who acted prior to S.544's effective date might be offered a defense or way around the consequences of S.544. Perhaps they could be given a chance to show that they relied on the separate corporate status of their borrower, and that they did not benefit from their borrower's dealings with others in the corporate group. Such creditors might be given a call on their corporate borrower's assets that ranks ahead of those who extended credit only to related companies in the corporate group. Allowing such a defense in effect reverses the existing presumption under which those dealing with the allegedly abused subsidiary have to take the initiative and establish their positive case. Creditors acting after S.544 will know the new rules of the game and adjust their lending practices accordingly.

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[8] See In re Palmer, Inc., 15 Bankr. 276 (N.D. Ill. 1981, aff'd 695 F.2d 1012 (7th Cir. 1982); Long v. McGlon, 263 F. Supp. 96 (D.S.C. 1967); Henderson v. Rounds & Porter Lumber Co., 99 F. Supp. 376 (W.D. Ark. 1951).

[9] See In re Twin Lakes Village, Inc. 2 Bankr. 532 (Bankr. D. Nev. 1980). And there is disagreement about the standing of a trustee in bankruptcy to bring alter ego claims against corporations related to the debtor. In re Ozark Restaurant Equipment Co., Inc., 816 F.2d 1222 (8th Cir.), cert. denied, 108 S. Ct. 147 (1987). Compare In re Vermont Toy Works, Inc., 82 Bankr. 258 (Bankr. D. Vt. 1987).

2. *The 30% Control Requirement.* Section 4(2) of the act requires 30% common ownership for airlines to be grouped together. In a widely held public corporation, it is quite possible, even likely, for a 30% shareholder to exercise effective control of a corporation. This is because there usually will be no other shareholder with nearly so large a holding and the costs of organizing the diffusely owned shares to fight a specific corporate battle is likely to be prohibitively high. It is worth noting that bankruptcy law treats corporations as "affiliates" if they share only 20% common ownership. 11 U.S.C. § 101(2). Affiliate status subjects corporations receiving preferences to a more stringent set of rules than those applicable to nonaffiliates. 11 U.S.C. §§ 547(b)(4)(B); 101(30)(E).

D. The Involuntary Bankruptcy Problem

One technical matter is worth noting. By the addition of new § 109(d)(2), the bill requires that all airlines in a controlled group file for bankruptcy if any one of them is to be eligible. This raises a question about initiating *involuntary* bankruptcies of airlines. Under § 303(a) of the Bankruptcy Code, only entities that may be debtors can be forced into involuntary bankruptcy. Since individual airlines within controlled groups would, under the proposed amendment, be ineligible to file for bankruptcy, a literal reading of § 303 would be that creditors are unable to force an individual member of an airline controlled group into bankruptcy unless they also could force the entire group into bankruptcy. Yet creditors may not be able to or wish to force the whole group into involuntary bankruptcy. The bill would benefit from a provision clarifying the relationship between involuntary bankruptcy and the new provision. Either involuntary bankruptcies still could be brought against individual members of a controlled group or the involuntary bankruptcy of a single member could trigger bankruptcy for the whole group.

If creditors can trigger a bankruptcy limited to one member of a corporate group, those in control of a group might find friendly creditors to trigger the involuntary bankruptcy of one member of the group. The involuntary bankruptcy would provide the group member with the benefits of bankruptcy but avoid subjecting the whole group to bankruptcy proceedings. Such a result threatens to undermine the spirit of the bill and could be avoided by a provision preventing a collusive involuntary filing by friendly creditors or possibly by judicial interpretation of existing good-faith principles applicable in bankruptcy.

Professor Theodore Eisenberg

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Books or Chapters in Books

Civil Rights Legislation (The Michie Company 1981) (2d ed. 1987)

1986 & 1983 Supplements to Civil Rights Legislation

Bankruptcy & Debtor-Creditor Law (Foundation Press 1984) (2d ed. 1988)

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Editor-in-Chief, Debtor-Creditor Law (Matthew Bender's 10 volume treatise)

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Miscellaneous Works

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The Realities of Constitutional Tort Litigation, Cornell Law Forum, June 1986, at 7 (with S. Schwab)

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In re Application of Gulf States Utilities to Change Rates, Docket No. U-17282, Before the Public Service Commission of Louisiana, May-June 1987 (testimony concerning the need to consider bankruptcy before granting rate increases attributable to imprudently incurred costs)

Invited Talks, Workshops, Editorial Boards

February 1989, presented "What Shapes Perceptions of the Federal Court System?" at a Syracuse University Law School faculty seminar

November 1988, presented (in absentia) "Litigation Models and Trial Outcomes in Prisoner and Civil Rights Cases" at a symposium on § 1983 at Georgetown University Law Center

October 1988, commentator on interpretation of 42 U.S.C. § 1981, at symposium sponsored by Federalist Society at Cornell University

April 1988, commentator on bankruptcy paper by T. Jackson & R. Scott at University of Virginia conference on Bargaining and the Law

March 1988, presented "The Influence of Judge, Political Party, and President on Civil Rights Cases" at a New York Law School faculty seminar

November 1987, presented "Constitutional Tort Litigation in Three Districts, the Government as Defendant, and Counsel's Incentives" at an NYU-sponsored symposium on the role of the federal courts (with S. Schwab)

November 1987, presented "Constitutional Tort Litigation in Three Districts, the Government as Defendant, and Counsel's Incentives" at a Harvard Law School Law and Economics Seminar (with S. Schwab)

May 1987, presented "The Influence of Judge, Political Party, and President on Civil Rights Cases" at a Law and Economics luncheon sponsored by Stanford Law School's Law and Economics Program

April 1987, presented "Constitutional Tort Litigation in Three Districts, the Government as Defendant, and Counsel's Incentives" at a work-in-progress faculty workshop at Stanford Law School

Professor Theodore Eisenberg

February 1987, presented results of further empirical study of civil rights litigation to the Fortunoff Criminal Justice Colloquium at NYU Law School (with S.Schwab)

January 1987, presented "Non-Word Processing Uses of Microcomputers" to the Law and Computers Section of the Association of American Law Schools

September 1986, presented "The Reality of Constitutional Tort Litigation" at Association of American Law Schools' Workshop on Civil Rights (with S. Schwab)

April 1986, presented "Bankruptcy in the Administrative State" at a symposium sponsored by Law and Contemporary Problems at Duke University Law School

Spring 1986, presented "Bankruptcy in the Administrative State" at a symposium sponsored by the Resource Economics Seminar, Cornell University Department of Agricultural Economics

January 1986, presented (with S. Schwab) "The Realities of Constitutional Tort Litigation" to the Torts Section of the Association of American Law Schools

Fall 1985, presented "Bankruptcy in the Administrative State" to the Boston University School of Law Faculty Workshop

Spring 1985, presented "The Undersecured Creditor in Reorganizations and the Nature of Security" at a symposium on Bankruptcy law sponsored by Vanderbilt University Law School

April to September 1986, Chair, Planning Committee, Workshop on Civil Rights, Association of American Law Schools

Board of Editors, Commercial Damages (Matthew Bender)

Work in Progress

Supplement (1990) to Civil Rights Legislation

Study of the application of the Supreme Court's intent standard in racial equal protection cases

Treatise on the Law of Fraudulent Conveyances (Little, Brown and Company)

Outside Grants Received

National Science Foundation, July 1985 to December 1987, Empirical Study of Civil Rights Cases (with S. Schwab)

Project '87 (a joint project of the American Historical Association and the American Political Science Association):to do an empirical study of civil rights litigation in the Central District of California.

Professor Theodore Eisenberg

American Bar Foundation: to expand and follow up the above study in the Central District of California and the Eastern District of Pennsylvania.

Courses Taught

Business Reorganizations Under the Bankruptcy Code (1 year)
Civil Rights Legislation (Constitutional Remedies) (8 years)
Corporate Taxation (5 years)
Bankruptcy & Debtor-Creditor Law (11 years)
Individual Taxation (5 years)

Previous Employment

Visiting Professor of Law, Stanford Law School (Spring 1987)
Visiting Professor of Law, Harvard Law School (1984-85)
Professor, University of San Diego's 1983 summer program at Oxford (taught Comparative Civil Liberties)
Professor and Acting Professor of Law, UCLA (1977-82)
Debevoise & Plimpton (1974-77)
Law Clerk to Chief Justice Earl Warren, retired (1973)
Law Clerk, U.S. Court of Appeals for the D.C. Circuit (1972-73)

Senator **Metzenbaum**. Thank you very much, Professor Eisenberg. I am not prepared to get into the issue of whether we do or do not have a right to pass an ex post facto law, since I do not believe this law is in any way ex post facto, by being made effective as of the day of introduction.

Mr. Farrell Kupersmith, Associate Managing Partner of Touche, Ross and Company of New York, we are happy to have you with us, sir.

STATEMENT OF FARRELL P. KUPERSMITH

Mr. **Kupersmith**. Thank you, Senator.

In the interest of time, to meet the Senator's request, I would ask that the prepared remarks be made part of the record so that I can use the 5 minutes——

Senator **Metzenbaum**. I might say that all of the full statements will be included in the record.

Mr. **Kupersmith**. Thank you, Senator.

My area of practice in my firm for the past 10 years has been in the area of reorganization, with respect to troubled situations both in and out of court. Really following up on Professor Eisenberg's remarks, I do not find that that which is proposed in the law, in the current bill, is revolutionary. As Professor Eisenberg remarked, there is alter-ego precedent as well as the concept of fraudulent conveyance.

I can tell you as a practitioner in this area those remedies are fundamentally ineffective, particularly as Professor Eisenberg alluded to where the parties to the transaction have, if you will, been careful to implement form over substance with respect to paper trails.

The reality is that at Eastern Airlines in its current financial crisis, there has been a systematic removal of value from the company, notwithstanding the company's denials of that. Cash has basically been removed, and Eastern in return has received an accumulation of substandard credit instruments, which have not only substantially weakened its economic performance, but have also materially drained its liquidity.

The remedy now under existing law puts a burden on creditors to fundamentally have to recover, and that remedy historically has not proven to be a very successful means of accomplishing that.

With respect to the legislation and the Department of Transportation's finding of fitness of Eastern in May of 1988, as you know, airlines conduct operations through the Government having granted a certificate, which requires fitness findings to be made on a continuing basis. Among those are managerial and financial resources.

Contrary to what was stated by the previous panel, the Department of Transportation, in fact, arrived at its finding of fitness for Eastern Airlines made on the presumption—which is only true if this legislation is passed—the Department of Transportation's findings specifically were predicated on the notion that there was one asset pool available at Eastern Airlines, Continental Air, and Texas Air.

In my prepared remarks, I have indicated, in fact, the specific citations in the Department of Transportation report. Their conclusion of fitness was predicated upon the availability of all of the resources of Texas Air and its subsidiaries being available, in fact, to support fitness. As to the transactions, which under current law the only remedy available is fraudulent conveyance and corporate alter ego, specifically the Department of Transportation chose not to comment on those, although in the findings of the auditors they, in fact, argued—and, if you will, in the appendix—that the transactions from the point of view of Eastern alone did not, in fact, make sense.

On March 2, Eastern Airlines sent a mailgram to its pilot force indicating that the current value of System 1 is $750 million, as compared to the $100 million paid by Texas Air in April of 1987 in the form of, if I might—Mr. Seiden said it was a note due in the year 2001. It is actually a note due, Senator, in the year 2012. He also indicated that the fairness of the transaction was such that Eastern could have converted the note into stock and gotten its money at the time. That is also inaccurate. The conversion price in the note was at a price that Texas Air stock has, in fact, never achieved. And, fundamentally, in a concurrent time frame, Mr. Lorenzo sold over 50 percent of his stock holdings in Texas Air.

That fact pattern puts creditors of Eastern now, having to use fraudulent conveyance and alter-ego, if you will, remedies, to basically reach through and bear the burden of recovering for the Eastern estate. Only this legislation makes the assets available of Texas Air and Continental Airlines to, in fact, support the Eastern Airlines presumption, which, in fact, was made by the Department of Transportation that there is only one asset pool available here.

If assets have no boundaries, we think equity demands that liabilities not have boundaries either. To basically live by the Department of Transportation's standard in evaluating the fitness of Eastern Airlines could only be reconciled from Alice in Wonderland, if you will, to reality if this legislation is passed. Without this legislation, there is not one asset pool, which is, in fact, what the Department of Transportation stated categorically in its findings. To do otherwise is to have, in effect, the regulatory process functioning on a presumption that it is inconsistent with current law.

[The prepared statement of Mr. Kupersmith follows:]

Testimony of Farrell P. Kupersmith

Good morning. My name is Farrell Kupersmith. I am Associate Managing Partner of the Firm of Touche Ross & Co. and as such am also a Partner in the Firm. Touche Ross & Co. is a member Firm of Touche Ross International, one of the world's largest professional services organizations. It has operations in 87 countries and employs more than 30,000 persons. The Firm's professionals provide accounting, auditing, tax, and management consulting services to clients in the public, not-for-profit, and private sectors.

I am a member of the Firm's Management Committee, which is responsible for the management activities of the Firm. I am also a member of the management consulting function's Management Committee, which functions as the Board of Directors for the Firm's management consulting operations.

Until 1987, I was the Managing Partner of Touche Ross' Reorganization Advisory Services (RAS) Group. As Managing Partner of the RAS Group, I was in charge of all services provided to parties-in-interest in troubled business situations in the United States. These services encompassed financial reorganizations, both in and out of formal court supervised proceedings. Engagements in which the Firm's RAS Group played a prominent role include: Braniff Airways, Air Florida, Continental Airlines, Storage Technology, LTV Steel, Wheeling-Pittsburgh Steel, McClouth Steel, Pantry Pride, Jartran, Bobbie Brooks, Roberts and Porter, Saxon Paper, Continental Illinois Bank, Penn Square Bank, Buttes Gas and Oil, and many others. Over the past several years, the RAS Group has actively participated in the recapitalization and restructuring of more than $25 billion of liabilities. The RAS Group has also participated in the renegotiation and restructuring of sovereign debt. As the Managing Partner of RAS, I was responsible for review and approval of the opinions expressed by the Firm in addition to having overall responsibility for quality assurance, engagement acceptance, staffing, and direct supervision of other Partners operating in the RAS practice area.

In addition to my responsibilities as a member of the Firm's Management, Strategy, and Capitalization committees, I am the Chief Executive Officer of Touche Holdings. Touche Holdings is a wholly-owned subsidiary of the Firm, created for the management of Partner and Firm capital, dedicated to wealth building investment opportunities.

The majority of my professional career has entailed evaluating companies and their strategies, their management, their potential, their plans, their capital structures and their cash flows. In addition, my professional activities have encompassed the evaluation of various securities that represent vehicles both for the settlement of liabilities and/or recovery of debt in the reorganization advisory context as well as for new investment. I have testified as an expert witness on numerous occasions, on the subject of corporate finance and structure as well as on other related matters.

Specific airline reorganizations in which I have personally participated include: Braniff, Air Florida and Continental Airlines. I have also conducted analytical assignments for investment groups involving TWA, Pan Am, People's Express, Eastern, Northwest, Republic and Texas Air. I was the Partner responsible for all of the firm's services relating to the Continental Airlines Chapter 11 reorganization which encompassed more than 28,000 man-hours with active participation on behalf of the formal court appointed Official Creditors' Committee, as well as direct monitoring of the Company's reorganization activities for the court itself. I have been responsible for my Firm's assignment at Eastern which has included comprehensive monitoring and analysis of Eastern since January 1988 on behalf of the Air Line Pilots Association ("ALPA"). My remarks today are in support of S.544.

The airline industry is cyclical, highly competitive and capital intensive. Commercial airline operations in the United States are conducted subject to a certificate issued by the Federal government which, among other fitness criteria, considers the adequacy of management and financial resources. In effect, the certificate subjects airlines to continuing fitness criteria, even under deregulation. If an airline does not meet the criteria, the Department of Transportation has the authority to withdraw its certificate without which the airline cannot operate.

While the fitness criteria ostensibly require adequate financial resources, there are no minimum capital requirements necessary to maintain one's operating certificate in good standing. This is a major flaw in the current regulatory system. Almost 20% of the industry has come under the control of a company whose senior debt is rated as speculative, which is paying almost 20% interest on its borrowings and is generating almost $8 billion in revenue with virtually no equity. This is deregulation out of control. Indeed, the ability to invest in property, plant and equipment, to remain competitive through economic cycles and to operate safely is in no small part affected by the mix and availability of capital resources.

In contrast, the commercial banking and savings and loan sectors, even in this period of deregulation, are required to maintain minimum capital levels in order to conduct operations.

In the recent fitness evaluation of Eastern Airlines, the Department of Transportation commented, "...we do not see a basis for concern over where in the Texas Air organization particular assets are held, provided that the location of an asset does not affect the ability of the carriers to maintain safe operations." (DOT Fitness Report, May 25, 1988, p. 57).

The Department of Transportation premise is flawed as evidenced by the fact that only Eastern filed for Chapter 11. Under the current bankruptcy law, it is material to Eastern's passengers, ticket holders, employees, trade creditors, bondholders and preferred stockholders where the assets reside.

The Department of Transportation concluded in May of 1988 that Eastern was financially viable even though in August, 1988, Eastern argued before Judge Barrington Parker that it could be close to a bankruptcy filing. The DOT report stated "... Because it is a holding company, Texas Air can shift resources among its companies for them to meet their financial and other commitments; thus Eastern's and Continental's shortfalls would not necessarily threaten either their viability or safety of operations ... provided Texas Air has the commitment and resources to assist them." (DOT Fitness Report, May 25, 1988, p. xiii).

In fact, Texas Air, the "holding company," has "shifted resources" primarily out of Eastern and into Texas Air and other subsidiaries. Eastern Airlines was profitable for four consecutive quarters beginning with the third quarter of 1986 and continuing through the second quarter of 1987 after two of the three unions at Eastern made substantial voluntary economic concessions in their contracts.

Since those four consecutively profitable quarters, Eastern has lost more than $600 million. Fuel prices have been favorable, labor has received virtually no pay or benefits improvements and the economic climate has been strong. In fact, 1987 and 1988 represent the best two years since 1978, when deregulation came into being. Except for Pan Am, Continental and Eastern, this has been a period of record profits for the industry. What happened at Eastern? Eastern's best assets have or have been attempted to be removed for the benefit of Continental and Texas Air, creating a cruel financial crisis at Eastern that has been used as the basis for demanding Draconian wage and benefit concessions as well as for systematically dismantling Eastern in the guise of building liquidity. Unfortunately, most of the affiliate company transactions generated non-marketable, substandard credit instruments for Eastern -- NOT cash.

Texas Air's notion is that it, the holding company, and Continental, the non-union airline owned by Texas Air, are immune and unreachable by Eastern's various creditor, employee and stockholder constituencies. Texas Air's actions of the last three years and the abuse of the holding company structure turn the Department of Transportation's premise, that there is only one asset pool, into at best a naively flawed assumption.

Allowing Texas Air, the holding company, and the other members of the control group to manipulate the affairs of Eastern and then have no responsibility for Eastern's liabilities is contrary to the Department of Transportation's stated assumption when it affirmed Eastern's financial fitness based on the premise that the assets of Texas Air stood behind Eastern. The Defense Contract Audit Agency findings acknowledged that many of the transactions did not make sense from Eastern's perspective. So long as the airlines require a government certificate to operate, public policy, in the form of law, should make the holding company that controls the airline be at risk for the liabilities of the airline without the benefit of the corporate veil. In this way, the holding company will be unable to manipulate and control the airline's affairs without risk, leaving others "holding the bag" of a bankrupt shell.

There is precedent in the pension area for this legislation. As you know, each and every member of a control group is jointly and severally responsible for the pension termination liabilities of each and every other member of the control group. This public policy should be extended to prevent abuse by use of a holding company structure whereby assets are moved around the board like chess pieces. If assets have no corporate boundaries neither should liabilities. This would not represent new government intervention -- the airlines can only function with the operating certificate whose fitness criteria explicitly includes adequate management and financial resources. It is akin to Alice-in-Wonderland for the Department of Transportation to assume the equivalent of a substantively consolidated asset base in evaluating fitness when, in fact, unless this legislation is enacted into law, there is not the reality of a substantively consolidated asset base.

The notion of what constitutes real versus hypothetical control is an important issue. Obviously 50.1% represents absolute control. However, effective control in most corporate situations can be demonstrated to be between 20 to 30%. It is virtually unheard of for shareholders representing more than 60 to 70% of the voting interests to exercise their franchise on any issue. Even in widely publicized, well financed proxy fights, involving high percentages of institutional ownership, the percentage of eligible shareholders exercising their franchise almost never exceeds 80%. Even then unanimity would be required to dislodge a 20 to 30% control group. These realities virtually ensure that the party with as much as 30% control is the equivalent of an immovable object unless that same party chooses to be removed; thus, the real exercise of control. Indeed, in its SEC filings, JET CAPITAL acknowledges that it controls TEXAS AIR with 34% of the voting interests of TEXAS AIR.

Dated: March 17, 1989

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Touche Ross

Farrell P. Kupersmith
Associate Managing Partner

April 13, 1989

Howard M. Metzenbaum, U.S. Senator
U.S. Senate
Committee on the Judiciary
Washington, DC 20510-6275

Dear Senator Metzenbaum:

This letter is in response to question #7 posed by Senator Thurmond in his correspondence dated 3/22/89.

The creditors of Continental Airlines and Texas Air Corporation would be paid from the operations and assets represented by all of the corporate entities including Continental Airlines and Texas Air Corporation in addition to those assets and operations of Eastern Air Lines.

I hope the above response is helpful. If there are any further questions, please contact my office at (305) 377-4000.

Respectfully submitted,

Farrell P. Kupersmith

Farrell P. Kupersmith
Associate Managing Partner

cd

cc: Ms. Theresa Lauerhass

Senator METZENBAUM. Thank you very much, Mr. Kupersmith. I was interested in your comment that the Department of Transportation finding of fitness encompassed the fact that all the airlines were intertwined and interrelated. I think that is a very significant fact that I had not known before. Thank you very much.

Our next witness is Charles M. Tatelbaum of Kass, Hodges and Massari, in Tampa, FL, on behalf of the American Bankruptcy Institute. Mr. Tatelbaum?

STATEMENT OF CHARLES M. TATELBAUM

Mr. TATELBAUM. Thank you, Mr. Chairman.

I am Charles Tatelbaum, an attorney from the Tampa Bay area, Florida, and speaking on behalf of the American Bankruptcy Institute. I have been a practicing attorney representing primarily creditors for 24 years, in the Baltimore-Washington area as well as in Florida. I have also been an adjunct professor at the University of Maryland School of Law dealing in creditors' rights and commercial transactions. I am currently the editor of publications for the American Bankruptcy Institute.

The American Bankruptcy Institute is an association of academicians, judges, practitioners, and public policy makers who have a professional interest in the field, and we are bipartisan and nonprofit.

I would like to speak to section 4 of the bill. It does two things: It brings into an air carrier chapter 11 all affiliated and related entities, as we have heard this morning, and substantively consolidates the proceeding. These are two separate issues. One is to whether or not they are, as I say, sucked into the proceeding and made debtors in chapter 11 by operation of the law; and then once they are in, are they then substantively consolidated?

As we have heard in the testimony this morning, the substantive consolidation takes away the individual identity of their being in Chapter 11 and creates this massive pool. Creditors of all are looking to the assets of all, and the total corporate identities are lost. This ignores, in our opinion, the separate corporate identity of these control groups, as well as their relative solvency.

Bankruptcy proceedings are designed to adjust and repay debts. Creditors, including those who are parties to collective bargaining agreements, already have sufficient rights and remedies available to them in the existing Bankruptcy Code. First and foremost, when entering into a transaction, creditors can investigate the financial strength of an air carrier and other entities, as they do. If the financial integrity of an entity changes so that a bankruptcy ensues, the Bankruptcy Code, using its own terms and applicable State law, we believe provides an adequate vehicle for avoiding and recovering any impropriety. And with all due respect, I take exception to my colleagues at the table when they say otherwise.

If such an impropriety has occurred, by the use of fraudulent conveyance provisions, insider preference provisions—which clearly could be applicable in this case if the facts so support—bankruptcy crime provisions—which under Title 18, section 152, are clearly applicable in a situation such as this—turnover of assets provisions or the like, the wrongs may be rectified.

In fact, the United States Court of Appeals for the Fifth Circuit in a very recent case called *Gibraltar* v. *L.D. Brinkman*, set forth a long opinion as to what can be done in such a situation to go after alter ego and suck in the assets of the parent if there is a wrong.

All of this, though, is done following a court proceeding where all of the parties have the right to present evidence and be heard. Our bankruptcy system is founded upon the congressionally stated and mandated principle of a fresh start to all honest debtors. This should not be abrogated by a statute without a judicial proceeding. If a judicial proceeding finds that they are not honest debtors or that there has been an impropriety, then the chips will fall the way they be.

Senator **Metzenbaum**. Mr. Tatelbaum, while you are speaking to that point, explain for me how this would work as a practical matter. If the company is in reorganization, then the company is really running the show, even though it is in bankruptcy court. Now, how does that situation develop to the point where they can pierce the corporate veil and go into some previous transactions that have been made? Because it would seem to me that there is no moving party to cause that to occur without having a trustee in bankruptcy.

Mr. **Tatelbaum**. Well, the Senator is quite correct, but there are vehicles within the code, if I may. There are vehicles for it.

As we have heard this morning, the Pilots Association has filed a motion for a trustee. The bankruptcy judge will hear that, and if—and I characterize it only because it has been in the media—the "parade of horribles"—and I have no information personally about it. But if the parade of horribles exists, then the judge, after hearing everything, will appoint the trustee to go after those parade of horribles. Alternatively, the debtor has suggested an examiner. The examiner, being totally independent, is then going to review the parade of horribles.

Senator **Metzenbaum**. What does the examiner do? I am not quite familiar with that. I know what a trustee is, but I am not that familiar with this new one.

Mr. **Tatelbaum**. The examiner, as Mr. Miller stated earlier, comes from the Bankruptcy Reform Act of 1978, and it is a middle step before the extraordinary step of a trustee to run the business. The examiner is totally independent, comes in at the behest of the court, and totally examines the acts and the conduct of the debtor on a future, ongoing basis and on a past basis, and investigates every transaction, especially those with insiders and related entities, to determine if any improprieties exist.

The report states facts, states recommendations, and then is submitted to the court for the court to then take further action based upon what this independent examiner has found.

Senator **Metzenbaum**. I assume the judge appoints him.

Mr. **Tatelbaum**. Yes, sir. The judge appoints him, or it. It can be an entity, such as an accounting firm or a legal firm. But there are very strict constraints about the independence and objectivity of that examiner, and the fact that the examiner also can no longer be involved in the proceeding as a trustee, et cetera, because you have to create the independence.

Just to conclude, Your Honor—excuse me, Senator. [Laughter.]

Old habits are very hard to break. The respect is there, sir.

Senator **Metzenbaum**. Thank you.

Mr. **Tatelbaum**. Bankruptcy courts for two centuries have dealt with these issues, and we believe that while the issues raised by this particular problem need to be dealt with, I would respectfully submit that applicable case law, statutory law, and the Bankruptcy Code provide a vehicle. It may not be the vehicle that some of the parties would like, but we believe that the Code is sufficiently protective of these issues.

Thank you for the opportunity of being heard, and I would also ask, while the record would be open for the seven days, the American Bankruptcy Institute would like to submit a more formal report because of the time constraints we had.

[The prepared statement of Mr. Tatelbaum follows:]

PRESENTATION OF CHARLES M. TATELBAUM
COMMITTEE OF THE JUDICIARY
UNITED STATES SENATE
MARCH 17, 1989

S. 544

Mr. Chairman and members of the Committee:

I am Charles M. Tatelbaum, an attorney with the Tampa, Florida law firm of Kass, Hodges & Massari, speaking on behalf of myself, as well as the American Bankruptcy Institute. I have been practicing bankruptcy law for 24 years in the Baltimore-Washington area and in Florida. I am Editor of publications for the American Bankruptcy Institute. The American Bankruptcy Institute is an association of academicians, judges, practitioners and public policy makers who have professional interest in the field of bankruptcy law and practice, and particularly in the organization and efficiency of the nation's bankruptcy court. The American Bankruptcy Institute is a by-partisan, non-profit educational institute.

Section 4 of the Bill does two things - it brings into an air carrier chapter 11 all affiliated and related entities and substantively consolidates the bankruptcy proceeding. This ignores not only the separate corporate identity of these controlled groups, but also their relative solvency. Bankruptcy proceedings are designed to adjust and repay debts. Creditors, including those parties to collective bargaining agreements, already have sufficient rights and remedies available to them in the existing Bankruptcy Code. First and foremost, when entering into a contractual or debtor-creditor relationship, they may investigate the financial strength of the air carrier. If the financial integrity of the entity changes so that a bankruptcy ensues, the Bankruptcy Code, using its own terms and applicable state law provide a vehicle for avoiding and recovering any impropriety. If such an impropriety has occurred, by use of fraudulent conveyance provisions, insider preference provisions, bankruptcy crime provisions, turn over of assets provisions or the like, the wrong may be rectified. All of this, though, is done following a court proceeding where all parties have the right to present evidence and be heard. Our bankruptcy system is founded upon the Congressionally stated and mandated principle of a fresh start being available to all honest debtors. This should not be abrogated by statute without the due process of a judicial proceeding.

Section 4 also creates a severe penalty for creditors of the non-debtor air carrier. By effecting the automatic substantive consolidation of all of the entities in the chapter 11 proceeding, creditors who in good faith and in reliance on long standing principles of contract law extended credit to a solvent, separate entity which happens to be part of a controlled group of an air carrier, have their property rights in their debt taken away without judicial due process as mandated by the Fifth Amendment to the Constitution.

For almost a century these issues have been dealt with by the bankruptcy courts. Creditors remedies exist in the present law to correct any impropriety. To correct a perceived wrong, this Bill would wreck havoc upon commercial lenders such as banks and insurance companies, trade creditors who are traditionally without collateral to secure their debt, the consuming public and employees of entities other than the air carrier whether or not they are protected by a collective bargaining agreement. All of this would be done automatically without any opportunity for a determination by a court of law as to whether the solvent entities should be brought into the bankruptcy proceeding. The National Conference of past bankruptcy judges has asked me to place in the record their opposition to the Bill.

Mr. Chairman, I thank you for the honor of the opportunity of appearing before you today, and would ask that my written statement supplemented by case materials be made a part of the record.

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April 4, 1989

RESPONSES BY CHARLES M. TATELBAUM TO QUESTIONS FROM SENATOR THURMOND
S.544

1. Not applicable to Charles M. Tatelbaum.

2. I do not believe that air carriers and airline unions should be removed from the procedures established by Section 1113 of the Bankruptcy Code which was enacted in 1984. While there is certainly a high public interest with respect to any airline industry bankruptcy, this public interest requires that no action be mandated on an absolute basis, but rather only after an impartial determination is made by a judicial officer - the Bankruptcy Judge. The collective bargaining process in the U.S. has various checks and balances built in so that no one side has an unfair advantage. If the process enacted by Congress in 1984 were to be removed from the airline industry, those representing labor in a collective bargaining agreement would feel free to act in a way which may not be construed as being in good faith since there would be no judicial review or legislatively mandated bargaining. The current system provides for appropriate fairness by all sides. Negotiation is at the heart of our collective bargaining system, and removing that by a legislative enactment takes away an impetus for good faith out-of-court resolutions. Section 1113 mandates negotiations following a Chapter 11 filing.

3. Not applicable to Charles M. Tatelbaum.

4. I strongly believe that S.544 will serve only to benefit or resolve a specific air carrier dispute, although, as noted in my responses to Senator DeConcini's questions, I am not certain that the remedy will create a cure.

There is no question that serious allegations of improprieties have been made against Mr. Lorenzo, Texas Air and the other entities involved with Eastern Airlines. If these allegations are true, the rights of creditors and those involved as employees of Eastern Airlines would have been adversely affected and prejudiced. The current law permits the Bankruptcy Court to redress these wrongs after a full and complete hearing where all of the facts have been presented. S.544 is an attempt to simply shortcut the process without having a judicial determination first made as to whether or not any improprieties exist. Our judicial system is built upon the principle of resolution of a dispute by an impartial arbiter after all of the facts and law have been fully and completely presented.

There has been some discussion that some changes should be made to the Bankruptcy Code dealing with airline bankruptcies, but these would have more to do with the industry as a whole, rather than a particular dispute. Consideration could be given to an amendment which would provide for a prompter payment to ticket holders of refunds when a carrier files for bankruptcy protection. Since the properties of a ticket are unique, special treatment should be provided for the general public when tickets are outstanding. This does not apply solely to air carriers. The same problems exist with the recent rash of filings of cruise ship lines, and the same could be said for rail carriers and bus companies as well. In fact, S.544 does nothing to deal with the problems associated with any other form of transportation bankruptcy other than airlines. If one were to assume that a transportation industry bankruptcy were to be filed that did not have the "taint" associated with the Eastern - Texas Air situation, the passage of S.544 would do nothing to assist the creditors, ticket holders, shareholders and the general public.

5. As correctly reflected in Senator Thurmond's question, the passage of S.544 would certainly make a parent company responsible for the debts of its subsidiary, and each subsidiary responsible for the debts of all other subsidiaries, where one of the entities was an air carrier. This has two separate consequences.

First, each of the affiliated entities would automatically be placed into a bankruptcy reorganization, notwithstanding the relevant solvency or financial independence, absent the common stock ownership. Second, once these entities were in bankruptcy, the assets and liabilities would be substantively consolidated to create the pool of assets to satisfy the liabilities of all. As noted in my response to Senator DeConcini's questions, this would have a material and adverse impact on the economy as a whole, and especially those persons or entities with legitimate trade claims against one of the related entities.

A further extension of the problem would deal with the stock of the parent entity, assuming it were to be publicly traded. At the first hint of a problem with a subsidiary entity, the stock of the parent would lose substantial value because shareholders would recognize that any equity that has been created for the parent would become vulnerable for the liabilities of the subsidiary. An even greater problem would be created with respect to the impact on any borrowings by any related entity. Institutional lenders look not only to the repayment ability of a prospective borrower, but also to the collateral base, even if the debt is to be unsecured. If a solvent separate entity that happens to be part of a controlled group involving an airline should seek to borrow funds, the prospective lender will, of necessity, be required to look at the loan in a different manner, and possibly seek additional collateral, higher interest or third party guarantees if the loan is to be made at all. This interference with an entity's ability to borrow will have a negative economic impact on the entire group of entities involved with the airline.

Virtually every major airline has encountered some financial difficulties within the last decade. If those involved with these carriers by the extension of credit or doing business with the carrier or affiliated entities were to have to be concerned that the Chapter 11 of one could trigger the substantive consolidation of all, the creditor confidence would be eroded so that it would be difficult for constructive problem resolution to take place.

The present statutory and case law provides for ample remedies should factual situations exist where there needs to be a consolidation of assets and liabilities to remedy a wrong. This, however, is only effected after the Bankruptcy Court has heard all of the facts pertaining to the particular issue, and has made the determination that sufficient facts exist to warrant the consolidation. This has the inherent protection to creditors and other interested parties since they may participate as parties in interest in the proceeding, and to the extent legally appropriate, their rights are protected. The existing procedure conforms with our country's long-standing legal principles of due process and equal protection.

QUESTIONS SUBMITTED BY SENATOR DECONCINI
REGARDING S. 544

QUESTIONS FOR CHARLES TATELBAUM

1) Proponents of S. 544 contend that amending section 1167 of the Bankruptcy Code is necessary to provide adequate protection to collective bargaining agreements when an airline has filed under Chapter 11 of the Code. Do you agree with this assertion? Please explain your position.

2) What do you see as the economic effects on the airline industry if S. 544 were to become law?

3) How would S. 544 benefit the average ticket holder?

4) From the outside looking in, it would appear that some of the transfers of assets by Eastern Airlines were not in the best interest of Eastern. Assuming that a transaction by an airline is intended to weaken the financial health of the airline, what recourse is available to creditors under the Bankruptcy Code if the transaction does not result in immediate insolvency, but contributes to future insolvency?

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RESPONSES BY CHARLES M. TATELBAUM TO QUESTIONS FROM SENATOR DeCONCINI
S.544

1. I do not agree with the assertion that an amendment to Section 1167 of the Bankruptcy Code is necessary to provide adequate protection for collective bargaining agreements when an airline has filed under Chapter 11 of the Bankruptcy Code. Subsequent to the Bildisco decision which was rendered by the U. S. Supreme Court, Congress enacted Section 1113 to the Bankruptcy Code which sets forth strict criteria which must be met by any entity seeking protection under Chapter 11 of the Bankruptcy Code and also seeking to modify a collective bargaining agreement. There was much debate following the Bildisco decision as to whether or not the previous standard of a "burdensome contract" should be applicable to collective bargaining agreements, or, instead, there should be a much stricter standard. Section 1113 clearly demonstrates the congressional intent that a very strict standard be imposed upon a Chapter 11 debtor prior to receiving the Court's authorization to reject a collective bargaining agreement.

Section 1113 sets forth seven specific steps which must be followed by a Chapter 11 debtor prior to the Court's authorizing the rejection of the agreement. These steps have been considered extremely onorous by management proponents, and eliminate the utilization of the section by most Chapter 11 debtors. In order to authorize the rejection of a collective bargaining agreement, the Court must virtually find that the entity cannot survive without the rejection or modification of the collective bargaining agreement, and that absent the Court's intervention, nothing will be accomplished on a non-judicial basis.

Incumbent upon the judicial system of our country and the Bankruptcy Code in particular is the traditional principle of a review of any adversarial matter by an impartial tribunal. Congress has determined when a litigant may seek a jury trial, but in all instances, a constitutionally mandated judge (Article

I or Article III) must impartially decide the merits of an issue after a full and complete presentation by the litigant and any other appropriate parties in interest. The proposal to amend Section 1167 would take away the use of this impartial tribunal in airline reorganizations where there is an effort to modify a collective bargaining agreement. There is nc question that an airline case invokes extreme public interest, and the rights of many creditors are affected. However, our constitutionally mandated system of justice frowns upon legislation which takes away from the judicial system the decision making power. The parties to the collective bargaining agreement, the debtor, the non-union employees, the trade creditors, the shareholders, the Internal Revenue Service and the public at large all have an interest in an airline bankruptcy reorganization. The rights of each must be considered by a judge in order to determine whether or not the mandates of Section 1113 have been met.

I believe that if Section 1167 were amended to exclude airlines from Section 1113, it would violate the long standing principle as noted above. Additionally, despite the vast public interest that has been generated by airline bankruptcy cases, nothing has been demonstrated which shows that these cases must be treated differently. The Bankruptcy Court is used to making decisions affecting the rights of many parties in interest in the shortest possible time. Because the bankruptcy judge has day to day experience in dealing with bankruptcy issues, he or she is best able to evaluate the factual presentation which now must be made if the debtor seeks to modify the collective bargaining agreement. To amend Section 1167 would be to automatically take away the rights of the debtor and, at the same time, possibly materially and adversely affect the rights of other parties in interest without the Court having an opportunity to review the merits.

I respectfully believe that the enactment of Section 1167 would set a dangerous precedent not only for the airline industry, but also for any other unique industry where there is public interest in bankruptcy reorganizations.

2. I believe that there would be substantial economic effects on the airline industry as a whole if S.544 were to become law as it is presently written. Since S.544 was introduced the day before the Chapter 11 filing of Eastern Airlines, and since S.544 provides for a retroactivity to the date of introduction, there is no question but that Texas Air and its affiliated entities would be impacted by the legislation. Some of the economic impacts would be the following:

(a) Creditors who extended credit in good faith to the various affiliated entities such as Continental Airlines, Brit Airways, Bar Harbor Airways and the like would not be paid when their debts came due. Instead, they would be required to wait several years for payment of their debts. The cumulative impact on these creditors would involve multi-millions of dollars, presumably a sum in excess of $100,000,000.

(b) Consumers who hold prepaid tickets on Continental Airlines would be unable to secure refunds in cash. If Continental continued to operate (see below), these passengers may be able to use their tickets. However, if other airlines refuse to honor previously issued tickets on Continental, Brit, Bar Harbor and the like, these consumers would be left holding unsecured claims in a bankruptcy case. This too would involve millions of dollars of consumer debt.

(c) The Eastern Airlines Chapter 11 has already impacted upon the commuter feeder carriers that had been previously associated with Eastern. Although these carriers have now changed their name to Continental Express, their passenger load is nil. Placing these airlines into a Chapter 11 case along with Continental would impair the job security of all of the employees of the air carriers.

(d) The public at large would refuse to book advance reservations on Continental and the feeder carriers. As has been demonstrated in prior airline bankruptcy cases, the mere hint of a bankruptcy frightens travel agents and consumers to such a degree that advanced bookings are not made. This then would have a domino effect on Continental and the feeder carriers since they would be financially impacted with their future business. Assuming that they are financially healthy at the present time, this financial health would rapidly deteriorate. This in turn would lessen the possibility of a successful reorganization for the consolidated entity as mandated by S.544.

(e) Travelers who have accumulated mileage credits in the Eastern and Continental One Pass program would probably lose their awards. Many people have planned vacation trips around mileage awards which have been earned over a period of years. The rights of all of the consumers holding mileage credits would then have claims in bankruptcy which may or may not be paid.

(f) The professional fees that would be mandated by a consolidated airline bankruptcy case such as with Texas Air, would be astronomical. Imagine the cost of separate bankruptcy counsel and separate bankruptcy accountants for each of the entities that are part of the controlled group. The principles of legal ethics would require separate representation. For each entity there would then have to be separate creditors committees with attorneys, accountants, investment bankers, appraisers and other professionals employed for each committee. The various entities and their committees would then quarrel with each other as to relevant solvency and cash flow so as to maximize the return to creditors for each entity. As a result, the bankruptcy proceeding itself would become extremely protracted, thus further increasing the cost. Assuming that an interest rate of 10% for the use of the money is not unreasonable, the calculation of the extent of the debt frozen by S.544 multiplied by the 10% per year loss to each of the creditors, creates an astronomical figure.

(g) Areas such as Florida, Colorado, California, Texas and Hawaii would have their tourism affected. I have noted that the State of Florida has already put forth statistics as to the number of dollars that have been lost because of the Eastern bankruptcy. If S.544 were to be enacted and this curtailed or eliminated Continental's service, the areas served would be affected.

(h) As noted in response to question number 3 below, because of market conditions, prices would go up for the average ticket holder, thus requiring the traveler presently utilizing discounted travel to pay substantially more for tickets.

Another impact on the airline industry would be the deterrent effect that S.544 would have on any new airlines or future airline reorganizations. An entrepreneur would be loathe to attempt to establish a new airline or reorganize an existing airline knowing that if there were to be an honest failure, all of the related entities of the entrepreneur may be thrown into a consolidated bankruptcy proceeding. By way of example, if Mr. Trump goes forward with the publicized plans for purchasing the Eastern Shuttle, it may be assumed that in the event of a failure of "Trump Airlines", the entire "Trump empire" may be part of the controlled group, and thus be part of the subsequently consolidated bankruptcy case.

Statistics show that bankruptcy has an adverse economic impact on any party affected by the bankruptcy, except the professionals employed in the case. S.544 if enacted, would have a negative effect on the economy of the United States based upon the sheer numbers involved with the Texas Air entities.

3. I strongly believe that S.544 would not benefit the average ticket holder and would, in fact, be a detriment. As noted above, if S.544 were enacted and Continental, Brit, Bar Harbor and the other affiliated entities were to be placed in a consolidated bankruptcy proceeding, not only would the existing ticket holders of Eastern be affected, but also all of the ticket holders of these other entities would have to file claims with the Bankruptcy Court. Section 507 of the Bankruptcy Code establishes a consumer creditor priority to the extent of $900.00, but there is no mechanism for these creditors to be paid outside of a plan of reorganization. The time that it would take to effect the confirmation of a plan of reorganization for a consolidated airline case such as Texas Air, would be extremely long. Ticket holders would simply have to wait in line just like other creditors.

Additionally, because travel agents and others would not be booking on Continental and the feeder carriers, the available seats via other commercial carriers would become even more limited. As has been demonstrated since the Eastern Chapter 11, the remaining carriers severely curtail discounted air travel where there is a heavy market demand. The passage of S.544 would create this demand in many markets served by Continental and the feeder carriers, and this would have the effect of driving up the prices that ticket holders would have to pay.

4. Assuming that some of the transfers of assets by Eastern Airlines were not in the best interest of Eastern or its creditors, and assuming that any transactions were intended to weaken the financial health of the airline, there is substantial recourse available to creditors under the Bankruptcy Code if the transaction does not result in immediate insolvency but continues to future insolvency. My answer will assume that Eastern Airlines remains in bankruptcy for the purpose of a response dealing with Eastern.

The Bankruptcy Code provides for the recovery of fraudulent conveyances which are effected within a specified period of time prior to the commencement of the bankruptcy case. Actual fraud is not necessary. The law provides for constructive fraud where the transfer is not for fair consideration, or leaves the transferor entity insolvent or with an unreasonably small capital. Additionally, preferential transfers to insiders which are effected within one year of the bankruptcy may be avoided. The Bankruptcy Code, as supplemented by the case law, gives creditors substantial rights to recover improper transfers made by a debtor prior to the commencement of a bankruptcy case.

As noted during my testimony, case law has created the principle of substantive consolidation. This means that if the Court is shown that there has been a requisite amount of co-mingling of assets and liabilities, the Court can substantively consolidate bankruptcy cases to the end and effect of pooling all of the assets of the entities to stand for all of the liabilities of the entities. This, however, is only done after the Court has had a full and complete hearing on the factual and legal issues involved. Incumbent with this is the right of creditors to seek an involuntary Chapter 11 action against an entity where the entity is unable to meet its debts as they come due.

In addition to the bankruptcy laws, state laws provide creditors with various remedies to correct improper transfers, both in and out of bankruptcy. A number of cases involving leverage buyouts have avoided transfers where the Court has found that the assets of an entity have been transferred to or for the benefit of the shareholders, to the detriment of the creditors and the on-going viability of the entity. These principles would apply in an airline case such as Eastern.

Senator DeConcini's question raises an interesting issue dealing with the transfer not having an immediate impact upon an entity, but one which will have an effect in the future. It is for this reason that S.544 is not a viable alternative to deal with the issue. The statutory law permits recovery under various circumstances, once there has been demonstration to the Court that the rights of creditors have been materially and adversely affected. There are also appropriate guidelines which determine when these transactions may be avoided, so that all parties are placed on notice as to what may happen.

With Eastern and Texas Air as an example or any other airline entity, there is substantial public interest and public awareness of everything that is on-going dealing with the financial health of the entity. The remedies available under applicable state, federal and bankruptcy law are sufficient to permit all creditors to avail themselves of remedial relief should the improprieties be proved.

Senator **Metzenbaum**. Let me be certain I understand your testimony. Has the American Bankruptcy Institute taken a position against this bill?

Mr. **Tatelbaum**. No, sir. We do not take positions. We only submit information. The position that has been stated is mine, based upon my experience, sir, and not of the institution.

Senator **Metzenbaum**. Thank you very much.

Now we have another witness speaking on behalf of the American Bankruptcy Institute, the Hon. William E. Anderson, U.S. Bankruptcy Judge for the Western District of Virginia, from Lynchburg, Virginia, also on behalf of the American Bankruptcy Institute. Happy to have you here, sir.

STATEMENT OF JUDGE WILLIAM E. ANDERSON

Judge **Anderson**. Glad to be here, sir, and perhaps occupying a different position from anybody in this room. I am not expressing anything for this legislation or against this legislation. I am here really representing the bankruptcy system.

I am a past president of the National Conference of Bankruptcy Judges and, of course, a member of the American Bankruptcy Institute. I found out about this legislation Wednesday and happened to be coming to Washington. Actually, I am here to perform a marriage ceremony this afternoon, and I just came in to make a few comments, if I may.

I am going to submit my written statement so I will not have to read through that. You have had copies of it provided to you yesterday.

What I am concerned about is taking some matters outside of the bankruptcy court, and I think this bill has some things in it that would perhaps do away with the jurisdiction of the bankruptcy court in bankruptcy matters. That concerns me a great deal.

As you are well aware, for about 10 years in the 1970's, we had a number of hearings concerning bankruptcies. In 1978 the final act was passed. Under that, everything pertaining to bankruptcy was brought into the bankruptcy court. They had jurisdiction of all matters pertaining to bankruptcy.

In 1984, when there were some amendments, there were some exceptions made, but, generally speaking, that is still true. And I see the fact that some of this is being taken away from the bankruptcy court and rulings made outside of the bankruptcy court as a problem for completing bankruptcy matters. And I say that because when a bankruptcy judge has complete jurisdiction over matters, he can move them along quickly, proceed with them as they should be proceeded with, know all the transactions that are taking place, and see that the matter is carried through in its entirety. I believe that the bankruptcy judges are perfectly capable of listening to both sides, as in this case, in making some fair determinations, and I do not think that ought to be taken away from them.

[The prepared statement of Judge Anderson follows:]

PRESENTATION OF
BANKRUPTCY JUDGE WILLIAM E. ANDERSON
COMMITTEE OF THE JUDICIARY
UNITED STATES SENATE
MARCH 17, 1989

S. 544

Mr. Chairman and members of the Committee:

I am William Anderson, a United States Bankruptcy Judge from Lynchburg, Virginia. I have been a bankruptcy judge for eight years, and I am active in the American Bankruptcy Institute and I am immediate past president of the National Conference of Bankruptcy Judges. I am speaking today on behalf of myself and the American Bankruptcy Institute. The American Bankruptcy Institute is an association of academicians, judges, practitioners, and public policy makers who have professional interest in the field of bankruptcy law and practice, and particularly in the organization and efficiency of the nation's bankruptcy courts. The American Bankruptcy Institute is a by-partisan, non-profit educational institute.

As a member of the judiciary, I have grave concerns involving the underlying principles of this bill. Our founding fathers based the Constitution upon the separation of powers between the executive, the legislative and judicial branches of government. Beginning as early as the Judiciary Act of 1789, the bi-centennial of which we are currently celebrating, this nation's courts have been the sole arbiter of civil disputes. This Bill takes away that role from the courts, and strips the Bankruptcy Code of protection for innocent creditors.

In 1984, in response to the *Bildisco* decision of the United States Supreme Court, Congress enacted Section 1113 of the Bankruptcy Code which imposes severe preconditions and limitations upon the rejection of a collective bargaining agreement in a chapter 11 proceeding. In order for the court to approve the rejection of a collective bargaining agreement by a debtor-in-possession, seven specific steps must be taken, and seven specific tests must be passed. It is then for the Federal judiciary to determine, after hearing testimony and receiving evidence, after weighing the statutory requirements and the principles of case law to then make the determination.

Debtors and creditors have rights as prescribed by statute. These rights are to be determined by the judiciary based upon the facts of each case. To paraphrase Senator Metzenbaum's statements on March 8, 1989 when the Bill was introduced, "it makes no sense to single out any group for special treatment".

When Congress passed the Bankruptcy Reform Act of 1978, it was made clear that the Congressionally mandated principle of a fresh start for honest debtors would continue it's century-long existence. I am frightened to think that consideration is being given to stripping the courts of the power to adjust the rights of debtors and all creditors merely to protect the special interests of a few, at the expense of many.

I thank you for the opportunity of participating today, I will be happy to respond to any questions, and ask that my written statement be made a part of the record.

THE HONORABLE WILLIAM E. ANDERSON'S ANSWERS TO QUESTIONS FROM SENATOR THURMOND

S.544 poses a potential burden for the bankruptcy courts in two ways. First, simple arithmetic shows that if an airline's entire controlled group must enter Chapter 11 with it, the courts' workload for such cases will be multiplied (approximately) by the number of other entities in the controlled groups. That many more debtors, creditors, and employees will be involved. Potentially, that many more motions and adversary proceedings would also be filed. Every aspect of such cases would be more comprehensive and voluminous.

Second, if airlines in Chapter 11 are subject to the Railway Labor Act but not Bankruptcy Code section 1113 (11 U.S.C. section 1113), and disputes arise as to working conditions or pay rates, then the court could not resolve the issue within the context and time-frame of the bankruptcy case. The controversy would have to be resolved under the Railway Labor Act provisions. This could result in lengthy delays over which the court would have little or no control, and it does not appear that such a resolution would necessarily take the interests of creditors into account.

QUESTIONS FROM SENATOR BIDEN

QUESTIONS FOR JUDGE ANDERSON:

I BELIEVE THAT THERE IS A DOCTRINE CALLED "SUBSTANTIVE CONSOLIDATION" THAT SOME BANKRUPTCY COURTS USE TO DEAL WITH SITUATIONS INVOLVING THE POOLING OF ASSETS AND LIABILITIES OF AFFILIATED CORPORATIONS.

IS THERE ANY SPECIFIC AUTHORITY UNDER THE BANKRUPTCY CODE FOR THIS DOCTRINE?

GIVEN YOUR EXPERIENCE AS A BANKRUPTCY JUDGE, WHAT ARE SOME OF THE FACTORS THAT A COURT WILL LOOK AT IN DECIDING WHETHER TO SUBSTANTIVELY CONSOLIDATE RELATED COMPANIES?

IS IT FAIR TO SAY THAT THE USE OF SUBSTANTIVE CONSOLIDATION REALLY DEPENDS ON THE PARTICULAR BANKRUPTCY JUDGE AND THE FACTS OF A PARTICULAR CASE, ESPECIALLY SINCE THIS IS AN EQUITABLE DOCTRINE NOT SPECIFICALLY SPELLED OUT IN THE BANKRUPTCY CODE -- IN OTHER WORDS, THAT THERE ARE NO HARD AND FAST RULES ABOUT WHEN THE DOCTRINE WILL BE USED, AND WHEN IT WILL NOT?

THE HONORABLE WILLIAM E. ANDERSON'S ANSWERS TO QUESTIONS FROM SENATOR BIDEN

Substantive consolidation is an equitable doctrine not specifically provided for by the Bankrutpcy Code. Bankruptcy Code section 105 has provided the general authority for bankruptcy courts to utilize this doctrine since that code section empowers the court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." 11 U.S.C. §105(a).

Case law has developed several factors to be considered before applying substantive consolidation to separate entities. These factors include: whether creditors have dealt with the related entities as a group; the existence of an overly complex entanglement of the related entities' business affairs; alter ego status between related entities; occurrence of fraudulent transfers between related entities; and existence of inter-corporate guarantees on loans. In re Augie/Restivo Baking Co., Ltd., 860 F.2d 515, 518 (2d Cir. 1988); 5 Collier on Bankruptcy ¶1100.06 (15th ed. 1979). According to the U. S. Court of Appeals for the Second Circuit, the two primary concerns are "(i) whether creditors dealt with the entities as a single economic unit and 'did not rely on their separate identity in extending credit' . . . and (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors." In re Augie/Restivo Baking Co., Ltd., 860 F.2d at 518.

Such consolidation itself is not for procedural convenience. It affects the substantive legal rights of the entities involved. Apparently, due process requires prior notice to creditors of all entities sought to be consolidated and an opportunity to be heard. See Seligson and Mandell, Multi-Debtor Petition - consolidation of Debtors and Due Process of Law, 73 Comm. L.J. 341 (1968). Among other things, assets are pooled, claims against the entities are pooled, claims between the entities are eliminated, claims are satisfied from the pooled assets, and creditors are combined to vote on reorganizational plan confirmation. Creditors of solvent entities sought to be consolidated with insolvent entities are at a particular risk of inequitable results. Since the goal of substantive consolidation is fair treatment for all creditors, the benefits of its application are weighed against the burdens before it is applied. This type of balancing test almost always requires case by case analysis of the pertinent facts in order to achieve equitable results for all creditors.

Senator METZENBAUM. I am not quite clear which rights are being taken away from the Bankruptcy Court about which you are objecting.

Judge ANDERSON. The contracts, labor contracts. As I understand the bill, it would be removed to another board or another hearing body to make a determination as to whether that would continue on or whatever ruling that body would see.

Senator METZENBAUM. You do not have that jurisdiction now with respect to railroad disputes, and what this legislation contemplates is that the airline industry and the railroad industry, which is generally in the law considered pretty similar—we try to make the two identical, with respect to the language pertaining to airlines as compared to that pertaining to railroads. You do not have that jurisdiction now in connection with railroads.

Judge ANDERSON. That is correct, sir. I do not want to appear to be taking management's side in arguing with you. I am not doing that. I am talking about the jurisdiction of the bankruptcy court. The railroads are entirely different, in my opinion, than airlines. Airlines are competitive. The railroads, one train runs from one town to the next, and Southern does this and B&O, or whoever it may be, runs from one place to the other.

When that was done—I believe in 1934 or 1935 it was passed—I think the situation was entirely different. I believe under the new Bankruptcy Code it was affirmed in 1978 and put into effect that a new body of modern feeling was taking place on how to handle these transactions. And I think the Bankruptcy Court is the place for them.

Senator METZENBAUM. Thank you very much, Judge.

Judge ANDERSON. I will be glad to answer any questions.

Senator METZENBAUM. One question off the record. Do bankruptcy judges have a right to perform marriages?

Judge ANDERSON. Yes, sir. In the State of Virginia, they do. Any judge in a court of record may perform the ceremony.

Senator METZENBAUM. I see. All right. Thank you.

Our last witness is L. E. Creel III, of Creel, Atwood and Phillips, P.C., Dallas, TX, on behalf of the American Bankruptcy Institute.

STATEMENT OF L.E. CREEL III

Mr. CREEL. My name is Ed Creel. I am from Dallas. I have been doing bankruptcy work for about 25 years. I specialize in debtor work. I represent companies in trouble. That is my business. I have been involved in the legislative process by appearing here several times when the 1978 bill was under way.

Let me give you just a moment about the American Bankruptcy Institute, because that is why Mr. Tatelbaum and Judge Anderson and I are here.

The American Bankruptcy Institute has about 2,500 members now. We are relatively new; we have been around 5 or 6 years. The stimulus for our birth was to be of assistance to the Hill when bankruptcy legislation was being considered. It is the ABI's position that it does not take positions. We are a forum made up of a number of diverse interests, all people involved in the insolvency process: lawyers, judges, accountants, businessmen, credit men, what have you.

A few days ago, when this bill came to our attention, as legislation on bankruptcy matters now does, and copies were sent out to a couple of us—and we had a chance to scan it, but to not study it as we would like—several things appeared to us as matters to which perhaps we could make you and your committee more sensitive.

The bankruptcy process is a very intricate one, as you know. It involves a lot of different interests: creditors 'interest, management interest, shareholder interest, public debenture interest, lender interest and so on and so on, not the least of which is employee interest. If any particular situation is considered, like the Eastern bankruptcy situation, and if that situation appears to have sufficient evils in it to generate fast legislation, frequently the result of any quick legislative action is to tend to upset what is a very delicate balance of a number of diverse interests.

For many years, when the 1978 bill was wending its way through the Congress, all of those various interests appeared, and the result of that process was a new Bankruptcy Code to cover all kinds of insolvency matters, including airlines.

Subsequently, a few years later, when the *Continental* case was in the Houston Bankruptcy Court, about the same time as *Bildisco*, the issue of collective bargaining came to the forefront. The unions were not happy; management was not happy. And so that particular matter was scrutinized during a series of hearings, and legislation was passed which resulted in section 113 of the Bankruptcy Code.

Section 113 is designed for the specific purpose of balancing the interests of labor and management, and it is set up with a clear mechanic that requires good-faith negotiations prior to court action, and only after those negotiations may court action be necessary.

It is certainly a given in modern-day commercial enterprise that the wage costs of any company is a significant cost, and it is one of those costs that needs to be weighed at the beginning of any kind of an insolvency problem in a bankruptcy proceeding. It does not seem appropriate to me to remove an area that is critical to the survival of a company outside of the Bankruptcy Code when there is a specific device that has already been created to solve that problem.

So our thought as bankruptcy practitioners is: Before some kind of fast action is taken to serve a special interest group, whether that be management or whether that be labor, careful thought be given as to what other effects that kind of fast action may have. For example, should collective bargaining agreements be relegated to Railroad Act dealings, the experience—the little bit that I know about it, and I do not know much—the experience that I have is that takes a very long time.

In a situation such as a major commercial enterprise entering into a bankruptcy case when it is having financial troubles, time is of the essence, and problems need to be solved quickly and heard quickly. A Bankruptcy Court is uniquely suited to that. That is its very best advantage to all of the parties involved.

Before we simply throw away section 113 with respect to airlines, we should be very careful to look at the effect that that would have, and to recognize that the stimulus for doing that, is one particular problem here for this committee. This stimulus coming as it does from labor unions, should not control policy. This particular problem should not control policy.

Any bankruptcy case is difficult. People always get hurt in bankruptcy. There is not enough money to go around. Little people get hurt, and big people get hurt. The purpose of the Bankruptcy Code, in its very carefully thought out structure, is to weigh all of the diverse interests and to treat them fairly and equitably as the best minds of all of us could have designed.

Another thing that bothered me——

Senator METZENBAUM. I am not sure I really got that point. Your point is that we should not act too precipitously based upon one company situation.

Mr. CREEL. That is correct, Your Honor—I did it, too, "Your Honor." I am sorry, Senator. I am more accustomed to "Your Honor."

Another thing that struck me as I read through the bill was it seems to me that what is being done here is that Congress is being asked to pass on legal issues that are already before the court. The thread that has run through this morning is that it is the suspicion—and justified or not, I do not know—but there is the suspicion that there have been a bunch of illegal transfers here between all of these companies, and that the company has acted improperly in a number of ways.

Those issues are before the bankruptcy judge now in this examiner/trustee appointment issue that I read about Friday. It seems to me that it is more appropriate, where there is a traditional means that has already been thought through, that is already on paper, to divest management of its power should it have acted incorrectly. It is best to have that issue heard by a court where there is evidence.

We do not make decisions on newspaper reports, and we do not make decisions based upon suspicions and things that we hear about. We do it with evidence in a courtroom.

I am out of time, but let me mention one other thing that bothers me. That is the retroactive effect of this legislation. It does not seem fair to me, to all of the creditors and people involved, and all of these other companies, that you change the rules now. When people make decisions, especially in complicated businesses, they make those decisions based upon existing law. It simply is not fair to change it. There have to be constitutional overtones there. We will provide some information on that basis.

Thank you.

[The prepared statement of Mr. Creel follows:]

Testimony
of
L. E. Creel, III
Dallas, Texas

My name is L. E. Creel, III. I am a bankruptcy practitioner in Dallas, Texas with the firm of Creel, Atwood & Phillips. I have been an active bankruptcy practitioner for approximately twenty-five (25) years, specializing in business bankruptcy matters. I am the past chairman of Dallas Bar Association Bankruptcy Section, of the State Bar of Texas Bankruptcy and Insolvency Section and of the Federal Bar Association Bankruptcy Section. I am a founding member, director and past president of the American Bankruptcy Institute. I have been certified as a business bankruptcy specialist by the State Bar of Texas. I frequently write and lecture for various organizations at bankruptcy seminars around the country. My practice is national in scope and is generally limited to the affairs of debtors. I have had the privilege of testifying before the Congress on a number of occasions with respect to bankruptcy legislation. I appreciate the opportunity to provide my thoughts regarding Senate Bill S.544.

The bankruptcy process is a sensitive balance between the interests of many conflicting parties, including debtors, management, shareholders, lenders, priority creditors, taxing authorities, trade creditors, workers, and other interest groups. The Bankruptcy Code of 1978 attempted to codify the decades of previous experience involving that process in order to achieve a careful balancing of all affected interests in those unfortunate cases in which economic circumstance necessitated bankruptcy relief. The legislative process that resulted in the Bankruptcy Code of 1978 took years to conclude, involved the testimony of hundreds of witnesses and required considerable and careful analysis by the members of Congress and their energetic staffs.

Although no sweeping legislation can be perfect, the Bankruptcy Code of 1978 was the synthesis of the thoughts and experience of a broad cross-section of experienced professionals involved in insolvency matters. It is inappropriate, unwise and destructive to tamper with that system of delicate checks and balances without the same careful consideration and analysis that initially put the checks and balances in place. Senate Bill 544 is such an attempt.

In the early 1980's, when the Bildisco and Continental Airline cases were before the Bankruptcy Courts, there was an attempt to create fast, new law in the area of collective bargaining agreements. The initial effort to quickly pass "special interests" legislation was slowed at least to the point that the new Section 1113 of the Bankruptcy Code was given a public forum and the input of diverse interests. The brief history of the legislative process which created Section 1113, if the initial bill introduced is compared to the bill that was ultimately inacted, clearly evidences the effect of public scrutiny and input.

It was my opinion then, and it is my opinion now, that the swift passage of "special legislation" is not consistent with the requirement of consummate thoughtfulness in the passage of legislation.

With that background, and with a plea that Congress always move slowly when many diverse interests, billions of dollars, and the lives and affairs of thousands of workers are involved in an insolvency situation that, at best, is tragic to the extent that it touches human lives, I make the following comments with respect to Senate Bill 544:

A. Adequate treatment of collective bargaining agreements exists. Section 1 of the Bill attempts to create a special category for a particular type of business, the airline business, with respect to collective bargaining agreements. Section 1113 of the Bankruptcy Code, as presently written, sufficiently protects the interests of all parties to collective bargaining agreements by creating a carefully structured environment within which meaningful negotiation must occur prior to the involvement of a bankruptcy court. If that negotiating process is unsuccessful, then, and only then, the bankruptcy judge may hear the positions of the affected parties, again within a carefully defined judicial environment, and then make those difficult decisions which are frequently necessary for a troubled business to ensure at least its survival of the bankruptcy process and the protection of the interests of all interested parties. To exclude the airline industry from the mechanism of §1113 of the Bankruptcy Code, while at the same time subjecting all parties interested in an airline company to the controlled arena of a bankruptcy court, makes it subject to two separate and inconsistent methods of reorganization, creates inconsistency and severely hampers the reorganization. For example, in railroad reorganizations, unlike general reorganizations, there is no "debtor-in-possession," no provision for manditory creditors' committees, etc. A railroad reorganization debtor is a completely different creature than a Chapter 11 debtor.

A procedure for dealing with collective bargaining agreements already exists; it has been carefully reviewed on at least two occasions in the last decade and the resulting structure should not be affected.

B. Access of all parties in interest to the bankruptcy court on disputed matters. By its very nature, a bankruptcy case involves business crisis and, except in the simplest of liquidations, constant emergencies, especially at the commencement of the case. All matters which deal with the survival of the business in its early bankruptcy stages must, if the business is to survive, be amenable to both negotiation (which is preferable) and litigation (when necessary). No part of a debtor's business should be insulated from the process of negotiation and judicial review where all affected parties can express their views and persuade. To eliminate the significant operating expense involving employee wages and benefits from the economic analysis attendant to the required restructuring of a troubled debtor's business is unrealistic and unfairly favors one interested party in a group of interested parties.

Sections 2 and 3 of S.544 represent the worst type of "special interest" legislation. Those two sections, read together, result in cementing in place the rights of one group of interested parties while leaving the rights of all other groups in flux. Such legislation leads to two improper results. First, in any case where collective bargaining agreements are involved, there is inherent unfairness benefiting the parties to that collective bargaining agreement (both management and labor) while at the same time not similarly binding the parties of other contracts. Second, if legislation is permitted to separate and fix the rights of parties to a particular type of agreement, presumably legislation can be created to benefit any selective group; thus leading to chaos.

C. Legislation defining rights presently in dispute. The issues with which Section 4 of S.544 deals are issues which are presently before a court. The parties to the disputes which Section 4 addresses are capably represented, have diverse views, are before a proper forum and are subject to an existing legal structure. There presently exist adequate remedies to satisfy those interests to the extent that a bankruptcy court (subject always to appellate review) may order.

For example, if allegations of the debtor's wrongdoing can be proven, the bankruptcy court can appoint a trustee to take over and control the affairs of the debtor. If improper transfers have been made by a debtor to other entities, then, upon a proper showing of proof, those transfers can be avoided and the assets or their value returned to the debtor's estate. Both of those areas of dispute are proper subjects for judicial scrutiny; both areas are controlled by many years of judicial precedent and statutory definition. To ignore the many years of history that give to the law its necessary predictability in order to accomplish the short-term goals of any group is improper and destructive.

Additionally, Section 4 includes language which ignores the separateness of corporation function and, as importantly, the rights of creditors to look to the assets of their customer for payment. It is unfair to the creditors of a solvent corporation to require the assets of that solvent corporation to be used to pay the debts of the creditors of an insolvent corporation. It is unfair to a solvent corporation to force it, by legislative fiat, to become a debtor in a bankruptcy case. Not only is it unfair to that solvent corporation, but it is unfair to its shareholders, its employees, its creditors, and all others who may be involved in it. Certainly, it is no secret that merely being a debtor in a bankruptcy case is destructive to the value of that debtor's business and its assets. No legislation should be enacted which can have the effect of requiring a healthy company to become a debtor in a bankruptcy case. No legislation should be enacted which would dictate, by special law, the result in a pending legal dispute which arises out of and is controlled by existing, thoughtful legislation.

D. Retroactive legislation. The citizens of a society are both entitled and required to pattern their lives and their affairs by the announced rules of that society. Without the structure of law, a society cannot be supported. Without the ability to rely upon predictable law, the members of a society cannot effectively and peacefully interact.

Section 5 of S.544 raises serious constitutional question as being an *ex post facto* law, and, provide the undesirable precedent for permitting law to relate back and, therefore, change the legal effect of the acts of citizens already concluded.

As a general princip~~al~~le, no law should be retroactive. Such a law is always inherently unfair as it applies to those who have the right and the duty to rely upon existing law at the time of their actions. It is true that, with respect to some tax legislation, an area of law where the communication of the steps in the tax legislation process is highly sophisticated, there have been examples of retroactive application of law. However, such application should always be an exception to the general constitutionally-protected principal that *ex post facto* laws are improper.

Certainly, in the context of a major commercial reorganization, the management of that company, its employees, creditors, shareholders and all others affected by it, should be able to rely upon existing law. When a major decision like filing a Chapter 11 bankruptcy reorganization petition and reacting to such a filing must be made, and all of the thoughts that go into such a decision must be carefully reviewed, and when the effect of that decision touches and affects so many interests, it is essentially unfair to later change that law, thus frustrating the rights and interests of all of those controlled by the law that existed at the time of their respective decisions.

The precise reason for the constitutional prohibition against retroactive legislation is clearly evidenced by this opposition to Section 5 of S.544.

In conclusion, therefore, it is my opinion that Sections 1, 2 and 3 of the bill are improper because they are based upon all the evils inherent in "special interest" legislation. The law of collective bargaining agreements, as it presently exists in Section 1113 of the Bankruptcy Code, adequately and fairly protects all of the interests of the diverse parties involved in collective bargaining agreements. Section 4 is improper because it, first, dictates the result, by legislation, of a pending judicial dispute and, secondly, adversely and unfairly affects the rights of innocent parties, where the rights of injured parties are already adequately protected by various provisions in the Bankruptcy Code. Section 5 is both unconstitutional and unfair in that it creates new rules and applies them to past decisions.

The involvement of Eastern Airlines in a bankruptcy case is unfortunate for all concerned. Business crisis and potential business failure is rarely positive. All parties involved in a major business failure are adversely affected. The purpose of the Bankruptcy Code and the purpose of the bankruptcy process to ease the burdens of all of those involved in the most fair and expeditious way that the best minds can fashion. Although not without fault, the present bankruptcy system, as embodied in the Bankruptcy Code, provides that system. Sometimes, and such is the case here, all of available alternatives, the most positive alternative is do nothing at all.

I thank the Chairman and the members of the Committee for this opportunity to appear.

QUESTIONS SUBMITTED BY SENATOR DECONCINI
REGARDING S. 544

QUESTIONS FOR L. E. CREEL

1) Mr. Creel, in support of S. 544, it is argued that bankruptcy courts fail to apply section 1167 correctly to airline collective bargaining agreements. Because of this misapplication, S. 544 mandates that renegotiation of collective bargaining agreements with airlines be treated the same as railroads under the Railroad Labor Act. It is further suggested that there is no reason to treat the railroad industry and the airline industry differently for purposes of renegotiating collective bargaining agreements.

In your experience with the Bankruptcy Code, have you found that bankruptcy courts have misapplied section 1167 to collective bargaining agreements in the airline industry? Do you agree that it is necessary to amend section 1167 as suggested?

2) How do you respond to the assertion that S. 544 would further the purpose of bankruptcy, ie. the reorganization of a troubled entity and fair treatment of creditors?

3) How would S. 544 benefit the average ticket holder?

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April 3, 1989

Ms. Theresa Lauerhass
Senate Judiciary Committee
Antitrust Subcommittee
Washington, D.C. 20510

Re: S.544

Dear Ms. Lauerhass:

I am pleased to enclose my answers to the questions sent to me by Senator Metzenbaum with his letter of March 22, 1989. I hope that those considering S.544 will find my comments useful.

Answers to Questions Propounded by Senator Dennis D'Concini.

Question 1. It is not my experience that the bankruptcy courts have misapplied Section 1167 of the Bankruptcy Code to collective bargaining agreements involving airline companies. Section 1167 of the Bankruptcy Code was intended to apply only in the reorganization of railroads. Section 1113 of the Bankruptcy Code was intended to apply to airlines. The legislative history related to Section 1113 clearly supports that distinction.

One of the significant influences causing the substantial revision of Section 1113 in 1984 was the pendency of collective bargaining agreement difficulties in the Continental Airlines case. When Section 1113 was redrafted, it was redrafted during a time when the airline industry was experiencing significant bankruptcy involvement. By changing the thrust of old Section 1113, which permitted almost unilateral rejection of collective bargaining agreements by debtors, to new Section 1113, which required a good-faith negotiation and the communication of pertinent information between factions before the intervention of bankruptcy court, the very issues now readdressed by S.544 were then carefully considered and acted upon. There seems no justification for changing the law again.

In fact, for the reasons included in my earlier testimony, the proposed legislation, which effectively eliminates the possibility of the warring parties reaching (or being forced into) a fast, negotiated compromise, is counterproductive to a bankruptcy system which is working.

Questions 2. S.544, by (i) requiring substantive consolidation of an airline and all of its affiliates, and (ii) denying to the debtor, the unions and all other parties of interest access to an expeditious Bankruptcy Court hearing to resolve labor disputes, as contemplated by Section 1113, does not further the purpose of reorganization. For airlines, those two proposed changes in the law will make airline reorganization virtually impossible.

Questions 3. S.544 cannot benefit the average ticket holder. In fact, it has no particular relevancy to the issue of "creating" money to pay back losses incurred by ticket holders who cannot use them, nor to generate business for the airline so that it can honor tickets previously issued. One of the arguments in support of S.544 was that, by some mysterious black magic, substantive consolidation would create additional value for ticket holders. That argument is illusory at best. There is simply no way that the far-reaching effects of bringing into a bankruptcy proceeding all of the debts and activities of affiliated companies of all airlines that may ever require bankruptcy relief can be predicted. If the long range effect of legislation cannot be accurately predicted, then it is unreasonable to argue the emotional supposition that "average ticket holders" can be benefited by substantive consolidation in a particular case.

One last point -- Question (1) suggests that, in the view of some, airlines should be treated the same as railroads. May I suggest for your consideration the following factors which seem to me to differentiate airlines from railroads:

a) When the Railroad Labor Act was passed in the 1930's, a sophisticated, well-understood and modern bankruptcy system did not exist. It is my impression, and I believe that evidence can be made available to support the fact that, railroads have not historically fared well as a result of the reorganization process. Continental Airlines is an example of an airline that did fare well in Chapter 11 of the 1978 Bankruptcy Code.

b) The railroad reorganization section of the Bankruptcy Code came from the old bankruptcy act of 1898, as amended in 1935. Its purpose was for the rehabilitation of a specific industry which, at the time, was facing severe economic conditions throughout the nation. Although the airline industry is presently facing economic difficulties following deregulation, the entire industry is not in the midst of a national crisis. In fact, the successful airlines are presently experiencing substantial profits. The unique treatment afforded railroads under the bankruptcy reorganization sections was designed to be sensitive to a generalized economic problem where the real competition of an active marketplace did not exist. The airline industry does not have a similar need. Chapter 11 reorganization is more functional for airlines (as is, specifically, Section 1113).

c) Railroad reorganizations differ significantly from airline reorganizations in that there is little competition between railroads over a given route from destination to destination. Typically, a railroad owned its tracks and rights-of-away; other railroads did not have access. Such is not the case with airlines. It is the practice, rather than the exception, that between popular destinations a number of airline carriers provide competing service. Thus, the railroad reorganization statutes which were promulgated over 50 years ago, in a different economic environment and designed to deal with the problems of a specific industry experiencing national economic failure was not intended and should not be used as the structure within which to deal with volatile labor management issues in a modern airline company. In fact, effectively with all of the effort that has gone into creating a modern bankruptcy code designed to deal with the economic troubles of any business in any industry, it seems far more reasonable to repeal the railroad sections of the Bankruptcy Code so that railroads, in the future, can be reorganized under the same Chapter 11 provisions that deal effectively with all other types of companies.

Answers Submitted by Senator Strom Thurmond.

Question 1. By eliminating the debtor-in-possession (i.e., the employer) itself from the decision process in accepting or rejecting collective bargaining agreements, and by relegating the negotiation process for collective bargaining agreements to Section 6 of the Railway Labor Act, the discretion of the bankruptcy court is not only limited and restricted; it is essentially eliminated. In a modern bankruptcy reorganization, where fast decisions may be required if a troubled company is to survive, a Section 6 forced negotiation process may well be fatal.

Question 2. The 1984 changes to the Bankruptcy Code relating to collective bargaining agreements, Section 1113, was designed for the specific purpose of encouraging good-faith negotiations prior to any changes in a collective bargaining agreement and, failing agreement, permitting the bankruptcy court to quickly utilize the necessary flexibility to allow the business of an airline debtor to continue while its overall financial problems (not just those limited to collective bargaining agreements) could be effectively dealt with. Air carriers and airline unions should not be removed from the carefully designed procedures prescribed by Section 1113.

Question 3. In my opinion, the fraudulent transfer provisions within the Bankruptcy Code and, just as importantly, in the Uniform Fraudulent Conveyance Act which is enacted in most states, and which exists in some form in every state, more than adequately protect creditors from improper transfers among related corporations.

Question 4. No answer.

Question 5. The basic difficulty with prospective substantive consolidation for companies not now known is that legislation is being proposed, the results of which are simply unknown and unpredictable. Business experience demands that, before long range and potentially destructive decisions are made, the predictability of such decisions must be known. S.544 is dangerous in that, by its very nature, it proposes to enact into law a major change in centuries of precedent without understanding fully the ramifications of the change. It is not hard to envision a set of facts where some future schemer could destroy a healthy airline by structuring the debt of affiliates in such a way that a bankruptcy filing, voluntary or involuntary, would require liquidation of the healthy airline; or where a creditor of an airline company could improperly leverage its position by threatening airline bankruptcy filing.

Question 6. One disadvantage of the proposed of amendment in Section 4 of S.544 is that the creditors of a healthy affiliate could have their rights to payment substantially diluted if forced to share the assets of their debtor with the debts of an insolvent affiliate.

Question 7. No answer

Question 8. Yes.

Question 9. Yes.

Question 10. No answer

Thank you for permitting me to answer these questions.

Very truly yours,

L. E. Creel, III

LEC:bhm

cc: Senate Judiciary Committee

Senator **Metzenbaum**. Let me just respond on that point alone, and then we will proceed.

There were a number of real estate transactions that were extant in this country before we passed the last law, which totally changed the rules. As a consequence, there were people who had entered into deals, who had put up their money, who had thought that the law was thus, and suddenly one morning after Congress acted—and you might say retroactively, but it really was not retroactive. It just talked about from that moment on—where the deal was totally different. Some companies actually, I think, had to go out of business, belly up.

Congress does that. You make a transaction, and sometimes Congress comes in and decides that, oh, they have a right to look at it.

Now, I understand what you are saying about the other creditors, but I cannot accept the suggestion that it is retroactive. It is effective as of the date of the bill going in, and it affects such bankruptcies as would occur thereafter. It is not those bankruptcies that would have been filed 5 years or 10 years ago, or 2 years ago, or 1 day before.

Mr. **Creel**. I do not have nearly your experience, but my recollection of the kinds of laws that tend to be back-dated are tax laws. That is a completely different area of law. That deals with the Government's power to tax as opposed to dealing with the private rights of individuals. And I think that distinction needs to be very carefully looked at. When business transactions are entered into, the parties to that contract must do it and have a duty to do it based upon the laws that exist. And it is simply unfair to change the rules later.

That is the way I perceive this bill.

Senator **Metzenbaum**. Well, you and I both know that the Supreme Court has spoken many times as to what Congress can and cannot do with respect to contracts. We are not really talking about that at the moment. We are now addressing ourselves to the question of the bankruptcy laws and whether or not in a bankruptcy, whether or not all of the assets of the parent and the affiliated companies are or are not subject to the creditors of one of the companies.

Mr. **Creel**. Now, there is a distinction there, Senator. With all due respect, you are dealing with contract rights. When you talk about "substantively consolidating"—which is a word of art in our business—when you talk about "substantively consolidating," what you are saying is that a creditor of Britt Airways, which may be a fine, healthy company, where that creditor has absolutely no risk of not getting paid, is going to get thrown, by legislative fiat, into a pot that may not have enough money to pay that creditor all the money he is entitled to, then that is not fair.

Senator **Metzenbaum**. I think it is of interest that this legislation has not been a secret, and we have not heard from any such creditors concerned about their loss of rights, their impairment. We tried to get creditors, creditors of Eastern and any other creditors. Our doors were open. And I think I am stating correctly that we heard from no one who wanted to come in because they were concerned that they as a creditor of some other affiliated company were going to be affected.

Mr. Creel. Well, they probably did not think about it. As soon as they do, I promise you, you will hear about them.

If I were a creditor, I would not be here for the ABI. I would be here as a creditor because you cannot do things like that.

Senator Metzenbaum. Well, I appreciate the testimony of the American Bankruptcy Institute and of these two witnesses. I do have a couple of questions.

Mr. Eisenberg, the testimony from Judge Anderson and Mr. Tatelbaum suggests that we would be acting in an unprecedented manner by "stripping the courts of the power to adjust the rights of debtors and creditors." Is the bright-line approach adopted in S. 544 unprecedented, and is it bad bankruptcy policy, in your opinion?

Mr. Eisenberg. In my opinion, there are many issues that are taken away from the bankruptcy courts, even under current bankruptcy law, including dealing with laborers for railroads. But also, if you think of public utility bankruptcies, such as the one in New Hampshire, the rate-making power of the State's rate-making authority is not stripped away, necessarily, in bankruptcy. And a very important piece of that bankruptcy is going to be what rates Public Service of New Hampshire gets to charge its utility customers.

That piece of the action in that bankruptcy case is not in the bankruptcy court. It is not that Congress acted to take it away, but there is lots of normal regulation that just does not get affected by the filing of a bankruptcy. So I would say it is not unprecedented. Indeed, it is the norm for most regulation to apply in bankruptcy. Criminal laws apply; tax laws basically apply. Lots of things apply in bankruptcy that the bankruptcy court basically has little control over.

Senator Metzenbaum. As you know, the Internal Revenue Code definition of controlled group relied upon under ERISA requires an 80 percent common ownership or voting control. Are you troubled by the requirement in S. 544 that in the airline industry 30 percent common ownership or voting control would be sufficient to constitute a control group?

Mr. Eisenberg. I would be surprised if 30 percent did not give people effective control of lots of publicly held corporations. Indeed, as I think you mentioned before, my testimony suggested the Bankruptcy Act has used as a measure of corporate affiliation 20 percent. Indeed, one might go lower than 30 percent. You know, there is no perfect number, but 30 percent strikes me as not too high or too low, whichever way it should go.

If I could add one thing, Senator, on the question of the efficacy of bankruptcy remedies, some of the disagreement is whether we should let the courts go ahead and have their whack at it and whether current doctrine is adequate enough. Mr. Tatelbaum talked about a recent case called L. D. Brinkman. In fact, in the Brinkman case, the jury made an alter-ego finding. It pierced the corporate veil. The district court would not allow that to stand, and the court of appeals affirmed.

I might read you some of the central language of the court of appeals opinion. It is one long sentence.

"We agree with the district court that the record evidence requires a conclusion that the subsidiaries: one, had their own staff, payroll, accounting department, auditors, and attorneys; two, kept separate books and accounts; three, filed a consolidated Federal income tax return separate from that filed by the parent corporation; were managed by separate boards of directors that had overlapping but not identical membership; and were centrally managed but had their own officers." And this is a case that says you cannot pierce the corporate veil.

Senator METZENBAUM. You cannot?

Mr. EISENBERG. You cannot. What it says, it seems to me, is: Honor the form and you can get away with the substance. That seems to me a major policy decision for Congress to make.

I would be surprised if Eastern and other corporate holding company conglomerates have not honored the form, but the courts just do not seem very willing to dig into seeing whether honoring the form is enough.

Senator METZENBAUM. Would you care to comment briefly upon whether making the law effective upon the date of introduction poses a constitutional problem for Texas Air's creditors?

Mr. EISENBERG. I do not see it. There are three areas of constitutional law that come to mind that might be the subject—raise a question about the effective date of the legislation. One is bills of attainder; two, ex post facto laws—both of which have been primarily, although not quite exclusively, limited to the criminal area, dealing with punishments. And this is very far afield from anything that the Supreme Court has held to be a punishment. The third possible area, it seems to me, of constitutional concern is closer to home for bankruptcy, and that is whether this might amount to a violation of due process or a taking of the interest of creditors who, before the effective date of the bill, had an interest against a certain corporation, and after the effective date of the bill, now find themselves in a pot in bankruptcy.

In fact, when you are talking contract rights and not secured creditors, when you are talking about simple contract rights and not liens on property, the Supreme Court has been very generous in allowing Congress leeway in adjusting the rights of unsecured creditors in bankruptcy. They have done drastic things to people, including—you have passed the Family Farm Act, the new chapter 12 of the Bankruptcy Act which affected all creditors lending to farmers.

But unless you eat into existing liens, there is very little in Supreme Court doctrine that suggests matters would be unconstitutional.

Senator METZENBAUM. I do have some questions for you, Mr. Kupersmith, but I just want to make one statement to be certain that when I advise my colleagues who are not here this morning, that I am stating it correctly. The American Bankruptcy Institute is here testifying through three representatives—one of whom is a Federal judge, the other one of whom is an author of a magazine called the American Bankruptcy Institute Newsletter, the third gentlemen who practices in this field—and the American Bankruptcy Institute does not have a position either supporting this legislation or opposing it. Am I right, Mr. Creel.

Mr. **Creel**. That is correct, Your Honor. We are here to advise and be helpful.

Senator **Metzenbaum**. Am I correct, Mr. Tatelbaum?

Mr. **Tatelbaum**. Yes, Senator.

Senator **Metzenbaum**. And, Judge, am I correct?

Judge **Anderson**. I am here for the interest of the Bankruptcy Court, not on one side or the other.

Senator **Metzenbaum**. You are not here on behalf of ABI?

Judge **Anderson**. I am a member of the ABI, yes.

Senator **Metzenbaum**. I see. OK. But you have taken no position?

Judge **Anderson**. I take no position. That is correct.

Senator **Metzenbaum**. I appreciate that. Thank you very much.

Mr. Kupersmith, what would be the effect of this legislation on competition in the airline industry? And would airlines be more or less likely to file for chapter 11 bankruptcy?

Mr. **Kupersmith**. I think they would be less likely. If, in fact, this legislation were the law of the land, there likely today would not be an Eastern Airlines bankruptcy, because the control group would have sought to use all forums to, if you will, work out the problems of Eastern Airlines, including the likely outcome that they would have had a different view on binding arbitration and/or Presidential Emergency Board.

Senator **Metzenbaum**. What would be the effect on other corporate transfers of assets if this legislation were to pass?

Mr. **Kupersmith**. Practically speaking, as opposed to what has been described by the panel in the law, as I indicated, I have been a practitioner in this area. I founded my firm's practice in this area. And there is virtually not a major reorganization that has occurred in this country that my group has not participated in, be it the Robins bankruptcy in Virginia, the Storch Technology bankruptcy, the Texaco bankruptcy and/or the Continental and Braniff bankruptcy, specifically two airline ones.

What has been described as being the remedies available under the law with respect to alter ego and fraudulent conveyance, places an enormous burden of cost and time on the parties and is almost inevitably not successful in any major case. Consequently, if you will, it is a remedy that exists but, practically speaking, is not very useful.

Senator **Metzenbaum**. Do you have any off-the-cuff estimate as to what additional drain there is normally of the corporate assets in those airline cases where there has been bankruptcy? In other words, have 10 percent, 20 percent, 30 percent of the assets been eaten up just by the expenses themselves?

Mr. **Kupersmith**. Much less so than that. Just talking about the pure cost of administration?

Senator **Metzenbaum**. Yes.

Mr. **Kupersmith**. It is an extremely expensive process. One has to relate it to the size of the entity. Continental Airlines, I believe, excluding labor-related litigation, the cost of prosecuting the bankruptcy was 20 or 25 million dollars. In the aggregate, I believe, in total, it was approximately $50 million. A very expensive process.

Senator **Metzenbaum**. Is that pretty generally true that it is a big eat-up of corporate assets?

Mr. **Kupersmith**. It is a very expensive process to go through a bankruptcy.

Senator **Metzenbaum**. The airline industry depends heavily on prepaid purchases of tickets. Is there any other industry in our country where bankruptcy has such a direct and dramatic effect on consumers? Can you think of one?

Mr. **Kupersmith**. No, not off the top of my head, Senator.

Senator **Metzenbaum**. Mr. Tatelbaum, it has been discussed this morning that the airline industry in recent years has had more than its share of questionable intercorporate asset transfers among parent holding companies and related subsidiaries. Given this pattern and the dramatic effect of an airline bankruptcy on the public, would you agree that a particular legislative solution geared to the airline industry is appropriate?

Mr. **Tatelbaum**. Senator, I think not only in the airline industry, I think in general. No one has actually said it, but the Bankruptcy Code does not have anything in the Code dealing with substantive consolidation. It comes from cases.

One thing that Congress could certainly consider, not just with the airline industry but in general, is to set standards for substantive consolidation. And certainly the airline industry, with its history of failures, cries out for that type of thing.

My opposition to the bill is that it is automatic. And I respectfully disagree with Mr. Eisenberg that it just shifts the presumption. It sucks in every asset into the case, and it draws in every creditor, including the prepaid ticket holders of Continental Airlines, the prepaid ticket holders of PBA and of Britt and of everything else, and gives them no alternative.

What our suggestion has been—on our own, not on behalf of the ABI—is to create a statute, as Congress did with section 1113 and say here are the standards, as tough as Congress wants to make them. Then let the bankruptcy court make that determination so that the balance is not changed.

But I agree with the Senator. Certainly, given the history of the airline industry, it cries out for some legislation dealing with it.

Senator **Metzenbaum**. Mr. Creel, you have criticized the application of the Railway Labor Act provisions to airline bankruptcies as "the worst type of special interest legislation." Now, Congress since 1933 has treated railroad employees differently under bankruptcy. That approach was expressly reaffirmed by Congress in 1978.

Is it your position that the application of the Railway Labor Act to railroad bankruptcies should be abolished?

Mr. **Creel**. No, I have no comment about Railroad Labor Act cases except that railroads do not do very well when——

Senator **Metzenbaum**. I am sorry. I did not hear that.

Mr. **Creel**. Railroads do not do very well when they try to work out their problems. They are not successful very often. Airlines at least can make it. The Bankruptcy Code permits them to make it. Continental made it through the process and is flying today.

The Bankruptcy Code is more modern; it is responsive to the needs of modern business; it has built within it all of the different criteria that are necessary in order for a company to emerge and be successful and re-enter the business market, which is the purpose of chapter 11 in the first place.

We should not forget the fact that we have a currently designed 1978 code that drew into it and into the discussions concerning it all of the experience of all of the people affected by it to create a brand new scheme, if you will, or structure to make companies survive. It makes no sense to carve any kind of a business out of that format.

If I had a magic wand, I would throw railroads into chapter 11's and get rid of separate treatment for them, because I think the Bankruptcy Code is very responsive to the needs of all businesses and I think it is very flexible.

It is that flexibility and the flexibility of the court and the ability of the court to move quickly in disastrous situations that makes it possible for businesses to survive. That is the hallmark of bankruptcy. That is why chapter 11 works. And it does not always work. Some companies are just broke, and you cannot fix them. But if there is a chance to fix them, their best chance of being fixed is in a flexible court with a flexible system that permits quick action and a structure that has been carefully created by all of the different adverse interests that went into the formulation of the Bankruptcy Code in the first place.

I feel very strongly about that.

Senator METZENBAUM. Mr. Creel, Mr. Tatelbaum talked about the fact that in the bankruptcy law, if there has been some siphoning off of the assets from one corporation to the other, that there are procedures that are available. Those procedures we all know, but they are quite difficult to prove.

As a practicing bankruptcy lawyer, would you not agree that proving that a corporation has siphoned off the assets of another corporation is very difficult, particularly if they have conformed with the specifics as laid out by Mr. Tatelbaum and Professor Eisenberg?

Mr. CREEL. No, I absolutely disagree with that.

Senator METZENBAUM. Do you think it is pretty easy just to go right through?

Mr. CREEL. I think that the means for proving it are relatively simple. The transaction that is involved may require complicated proof, but the concept is very, very easy.

A trustee or a debtor in a bankruptcy case has got the right to use State statutes to overturn transfers that are fraudulent. Fraudulent transfers fall into two very simple categories conceptually. A transfer that is made with the actual intent to cheat creditors is one category. Actual intent is sometimes difficult to prove, but most State statutes and the Uniform Fraudulent Transfer Act lay out a series of badges of fraud that are relatively easy to identify.

The other kind of fraudulent transfer is an arithmetic test. It is not a transfer that is fraudulent in the evil sense. It is a transfer that is fraudulent in the dollar sense. It is an equivalency test. If I give you a sack of apples that is worth $10 and it is really worth $20, then I have defrauded my creditors because I have cheated them out of $10. So I can get—or they can get, more importantly, the value of that sack of apples back.

That is not hard to understand. If Eastern Airlines took an asset and sold it too cheap to help one of its sister companies, then the test is: What did it give up? What was it worth? That is a value problem. What did it get? What is it worth? That is a value problem. And you simply weigh them.

Senator METZENBAUM. Yes, but we have just heard of one this morning. Texas Air sold its reservation system, for $100 million. Mr. Seiden indicated that there was a value to it over and beyond that which appeared on its face. The price was to be paid, at 6.5 percent, payable in 2001. Then Mr. Seiden said that there were also some convertible rights to convert into Texas Air stock. Another witness—I do not remember which one it was at this moment—made it clear that the conversion price was substantially higher than Texas Air stock had ever been.

Now, putting all of that on its face—and that is all there is—it is pretty hard to prove that is fraudulent.

Mr. CREEL. No, it is not. With all due respect, it is not difficult.

Senator METZENBAUM. Do you think it is fraudulent?

Mr. CREEL. I have no idea what the facts are, but I know what I do——

Senator METZENBAUM. I just told you the facts. That is all there are.

Mr. CREEL. If you assume that somebody took a system worth $200 million and gave it away for a junk piece of paper that was worth 25 cents, of course it is fraudulent. But I do not know that those are the facts, and with all due respect, neither do you.

Mr. EISENBERG. Senator, if those are the facts, I might add, even under fraudulent conveyance doctrine, you could not attack it if, after that transaction, Eastern was solvent.

Mr. CREEL. The reason for that is that nobody is hurt.

Mr. EISENBERG. Well, it is hard to say nobody is hurt if you strip off $200 million of shareholder and creditor cushion and then leave a company in bankruptcy and say no one was hurt by the earlier siphoning off of $200 million; it is only the last $100 million or so that really hurts.

The truth is fraudulent conveyance doctrine requires a showing of insolvency at the time of the transfer, and that itself is quite difficult to prove.

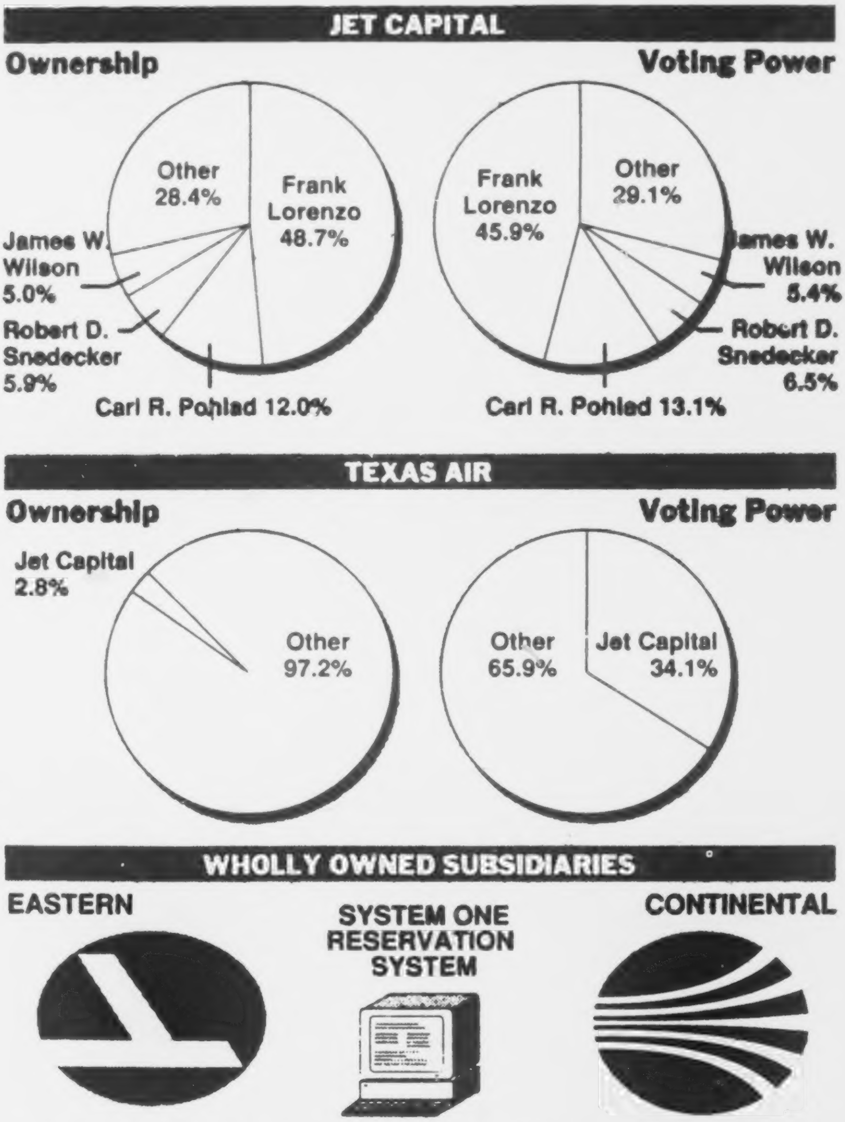
Senator METZENBAUM. Gentlemen, I want to tell you that I am very grateful to you for my education this morning. I learned much from all of you. I appreciate your participation, and your entire statements will be included in the record.

This hearing stands adjourned. There will be written questions submitted to probably each of you from various members.

[Whereupon, at 1:02 p.m., the committee was adjourned, subject to the call of the Chair.]

APPENDIX

Ownership and Control of an Airline Empire



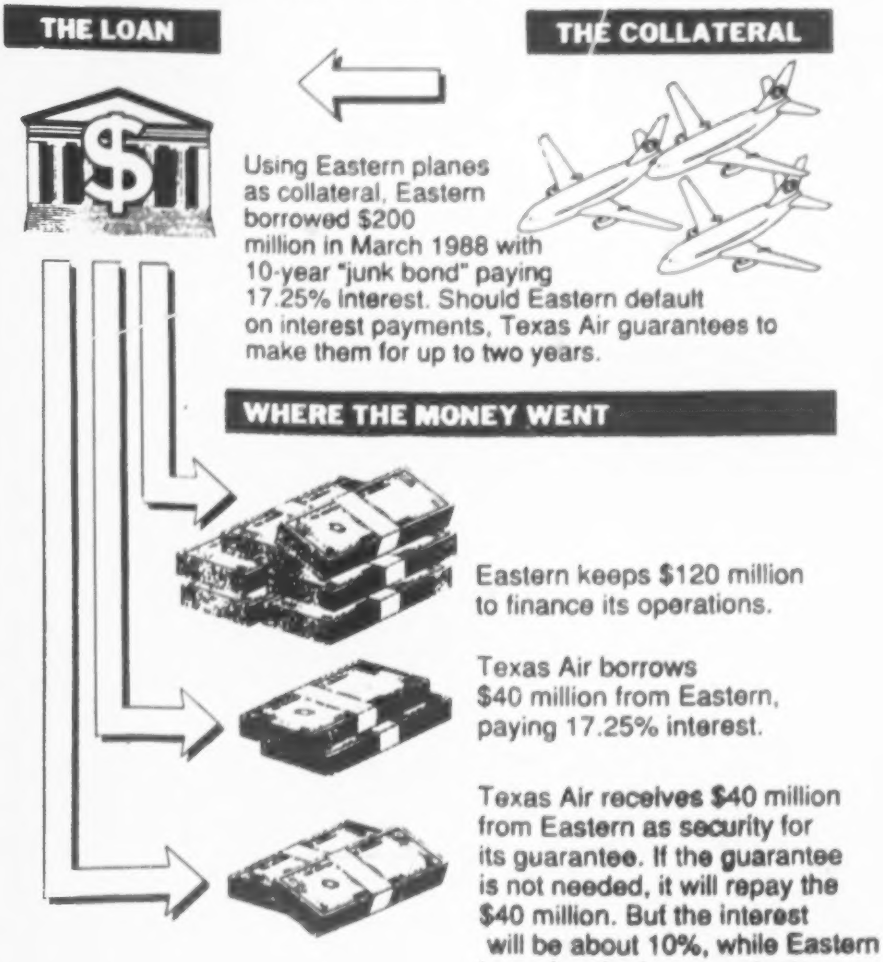
Before the strike, Texas Air controlled about 20% of the U.S. air carrier market. Texas Air has maintained Eastern and Continental as separate entities, and most of Continental's employees are non-union.

Source: Company reports

Reprinted from the *New York Times*, March 20, 1989

How Texas Air Raised Cash

Questions have been raised about the disbursement of the proceeds from an Eastern loan. It has been charged that Texas Air used it to get working capital at Eastern's expense. Texas Air contends the arrangement was necessary to help Eastern obtain the loan.



THE LOAN

THE COLLATERAL

Using Eastern planes as collateral, Eastern borrowed $200 million in March 1988 with 10-year "junk bond" paying 17.25% interest. Should Eastern default on interest payments, Texas Air guarantees to make them for up to two years.

WHERE THE MONEY WENT

Eastern keeps $120 million to finance its operations.

Texas Air borrows $40 million from Eastern, paying 17.25% interest.

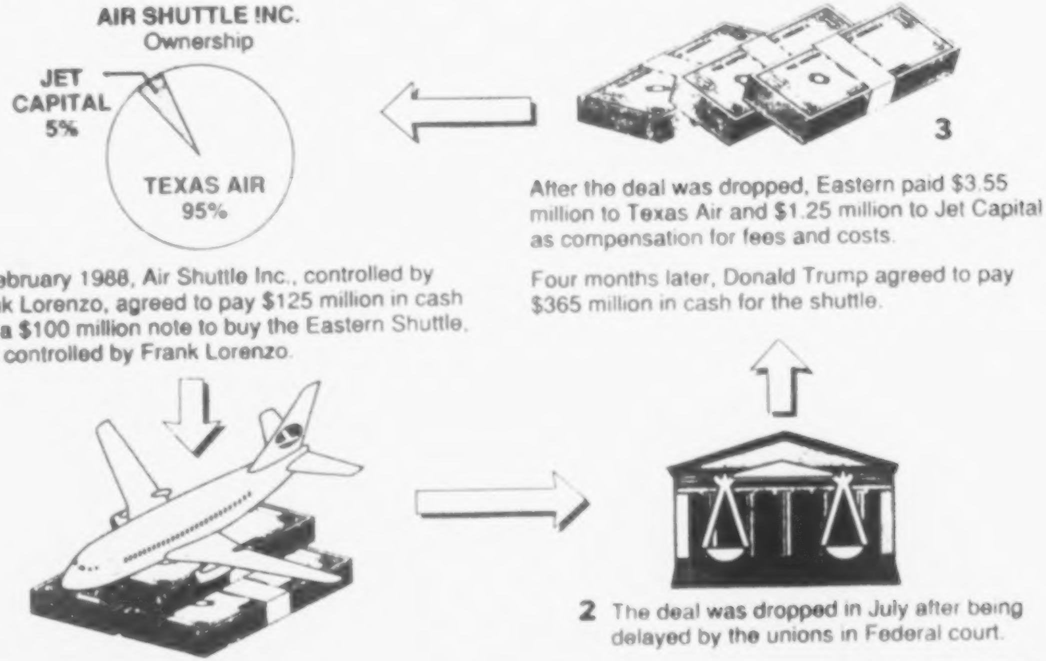
Texas Air receives $40 million from Eastern as security for its guarantee. If the guarantee is not needed, it will repay the $40 million. But the interest will be about 10%, while Eastern is paying the junk bond rate.

Source: Company reports

Reprinted from the *New York Times*, March 20, 1989

How Texas Air Sought to Buy Eastern's Shuttle From Itself

Fearing a strike and seeking cash, Texas Air devised a plan to buy the Eastern shuttle and pay Jet Capital investment banking fees in the process. Unions contended the deal would have diverted valuable assets away from Eastern. The prospective buyer, Air Shuttle Inc., was owned by Texas Air and Jet Capital.



1 In February 1988, Air Shuttle Inc., controlled by Frank Lorenzo, agreed to pay $125 million in cash and a $100 million note to buy the Eastern Shuttle, also controlled by Frank Lorenzo.

2 The deal was dropped in July after being delayed by the unions in Federal court.

3 After the deal was dropped, Eastern paid $3.55 million to Texas Air and $1.25 million to Jet Capital as compensation for fees and costs.

Four months later, Donald Trump agreed to pay $365 million in cash for the shuttle.

Source: Company reports

Reprinted from the *New York Times*, March 20, 1989

Arent, Fox, Kintner, Plotkin & Kahn

Washington Square 1050 Connecticut Avenue, N.W.
Washington, D.C. 20036-5339

David J. Aronofsky
(202) 857-6054

March 24, 1989

Via Messenger

The Honorable Howard M. Metzenbaum
Committee on Judiciary
United States Senate
224 Senate Dirksen Office Bldg.
Washington, D.C. 20510

Dear Senator Metzenbaum:

As Washington counsel to the Independent Federation of Flight Attendants ("IFFA"), the collective bargaining representative for TWA's 9,000 plus Flight Attendants, we are pleased to submit five copies of IFFA President Vicki Frankovich's statement in support of S.544. IFFA greatly appreciates the opportunity to participate in Committee deliberations on this long overdue legislation and wholeheartedly commends you for introducing it.

Please do not hesitate to have your staff contact either Ms. Frankovich or Joan Wages at IFFA (212/818-1130), or me if we can further assist the Committee on this matter.

Sincerely,

David Aronofsky

Telephone: (202) 857-6000 Cable: ARFOX Telex: WU 892672 ITT 440266 Telecopier: (202) 857-6395

COMMITTEE ON JUDICIARY
UNITED STATES SENATE
WASHINGTON, D.C.
March 23, 1989

STATEMENT OF SUPPORT FOR S.544

Submitted By:

Victoria Frankovich, President
Independent Federation of Flight Attendants
630 Third Avenue
New York, New York 10017
212/818-1130

The Independent Federation of Flight Attendants ("IFFA"), collective bargaining representative for TWA's 9,000-plus Flight Attendants, commends Senator Metzenbaum for introducing S.544 and wholeheartedly supports its passage. The TWA Flight Attendants, along with all other TWA employees, have compelling reasons for desiring enactment of S.544 based upon our own experiences with TWA owner Carl Icahn. This legislation, which permits a bankrupt airline's creditors to reach carrier parent and affiliate corporation assets while barring unilateral changes in employee wages or working conditions, attacks egregious airline holding company abuses inflicted upon innocent carrier creditors, consumers, employees and the public by predatory carrier owners.

Senator Metzenbaum farsightedly observed upon its introduction that S.544 "would prevent Frank Lorenzo and any other airline buccaneers from using bankruptcy to escape their creditors and destroy their workers." Besides countering Mr. Lorenzo's financial destruction of Eastern, this bill could be essential in thwarting Carl Icahn's continued systematic looting of TWA assets on a scale perhaps grander than that characterizing Texas Air. As demonstrated below, this legislation is clearly in the public interest and reflects sound public policies for the airline industry.

1. Icahn Holding Company Abuses Addressed By S.544 Have Left TWA A Debt-Ridden Shell Vulnerable To Eastern-Like Insolvency.

Last August, IFFA challenged Carl Icahn's proposed privatization of TWA in an air carrier fitness proceeding initiated at the U.S. Department of Transportation. (DOT Docket No. 45792)(Tab A). ALPA and the Consumer Federation of America subsequently joined IFFA in asking DOT to halt the privatization, essentially a junk bond-financed leveraged buy-out of Carl Icahn's publicly held TWA stock using carrier cash flow as collateral, pending full DOT investigation of the transaction's consequences. IFFA financial experts, bolstered by CFA's own expert analysis, concluded largely on the basis of TWA's own SEC disclosure statements that the proposed privatization would strip TWA of virtually its entire liquid asset base by:

- Transferring $140 million in cash plus some $210 million in long term debentures to non-Icahn public shareholders in TWA;

- Paying $469 million in cash or cash equivalent marketable Texaco and USX stock held by TWA (after being purchased with money borrowed by the carrier in part through junk bond financing) plus an additional $196 million in dividend-paying preferred stock to various other Icahn-owned corporate affiliates, in return for nothing of discernible value; and

- Obligating TWA to pay yet another $40 million per year in cash dividends to Icahn affiliates.

In other words, the proposed transaction enabled Mr. Icahn to eliminate most of TWA's liquid asset base by exchanging the carrier's cash and marketable blue chip securities to various Icahn affiliates in return for relatively worthless shares in the newly privatized airline (Tab B). It should be noted that Carl Icahn's various non-airline affiliates of TWA had continuously utilized the carrier as a vehicle for borrowing money to acquire the investment grade Texaco and USX stock, although neither the stock nor the proceeds derived from its sales have ever been used to benefit the airline itself.

The Icahn privatization of TWA left the carrier with:

- A $2.6 billion debt;
- A 13-1 debt-equity ration (three to four times the ratio for financially distressed companies);
- A negative net worth;
- Annual interest obligations of nearly $500 million, nearly twice as much as its projected cash flow was expected to cover;
- One of the oldest fleets among all major carriers, with neither financial resources nor a credit rating sufficient to acquire new planes; and
- A company highly susceptible to insolvency to the extent that the carrier's transferred liquid assets described above are now owned by other Icahn corporate entities and thus shielded under present law from TWA creditors.

Certain attached Exhibits (Tabs C-E) reflect various experts' analyses and conclusions that the TWA privatization has rendered the airline a financial disaster waiting to happen.

A review of the TWA fitness proceeding documents at DOT reveals a nearly inpenetrable maze of Icahn corporate affiliations which puts the Lorenzo Texas Air "empire" to shame in terms of the former's complexity, and more importantly its ability to "upstream" airline assets in the very manner which triggered the introduction of S.544. (Tab F). Moreover, unless this legislation passes, TWA's creditors could soon be holding the same proverbial "empty bag" as those at Eastern since TWA's ownership appears to have altered virtually none of the carrier's adverse financial conditions described above. Although TWA's employees have tried to halt the carrier's financial disintegration through regulatory agency and (in the case of pilots and machinists) legal actions, additional legal measures such as those provided for in S.544 are clearly needed to resolve this problem.

Concerns about the harm of TWA's privatization extend well beyond the employees. The Wall Street Journal has placed the privatization among the nation's 10 most financially troubling LBO's. (Tab G). Barron's observed that "what Icahn has really done is to restructure the airline into a hollow shell filled with debt, and assure that much of the cash and stocks bought with the proceeds of the debt will wind up in his hands." (Tab H). Business Week concluded that Carl Icahn was essentially using the airline as little more than a corporate raiding vehicle. (Tab I). Apparently concerned about TWA's inability to pay off the long term debentures given non-Icahn shareholders as part of the privatization pay-off, several top TWA executives rejected this alternative in favor of less valuable but more readily available cash. (Tab J).

The TWA privatization activities likewise did not go unnoticed in Congress. Numerous Senators and House Members wrote DOT to request initiation of a carrier fitness investigation. On September 29, 1988, the House Public Works and Transportation Subcommittee on Investigations and Oversight, chaired by Congressman James Oberstar (D-MN), conducted a full day of hearings on the transaction (Tab K). At that hearing, the TWA Flight Attendants, pilots and machinists all opposed the privatization on the ground that it would leave TWA a badly crippled airline less capable of competing in today's deregulated environment while personally enriching Mr. Icahn and his other corporate affiliates.

The employee groups also expressed grave concerns over being forced to fly in some of the nation's oldest aircraft at a time when fleet age was already becoming a national safety issue, especially since TWA was compiling the highest FAA accident-incident ratio in the airline industry while being referred to as a "flying dinosaur." (Tabs L-M). Despite the Subcommittee's invitation, Mr. Icahn refused to testify at the hearing and describe his own plans for the airline's future. TWA's principal witness, General Counsel Mark Buckstein, proved either unwilling or unable to do so, although he did refer glowingly to the number of new Icahn subsidiary corporations formed to engage in everything but the airline business itself.

The Icahn corporate empire evokes memories of the late 1920's, when the collapse of speculative holding company pyramids in utilities and other comparable industries helped trigger the Great Depression. Then, as now, holding companies siphoned off cash generated from their operating subsidiaries' primary public service activities for market speculation purposes through affiliated corporate shells which undermined primary company fiscal integrity. Then, as now, assets became highly leveraged and risky debt instruments remarkably similar to junk bonds were in vogue. The ensuing market crash and related scandals resulted in new laws imposing strict regulatory control over utility and financial institution holding companies. See J.K. Galbraith, "The 1929 Parallel," Atlantic Monthly (Jan. 1987) (Tab N); Federal Trade Commission Report on Commercial Electric Power Company Ownership, S. Doc. No. 213, 69th Cong., 2d Sess. (xii-xiv) (1927) (describing rampant holding company abuses subsequently cited by Congress as the basis for new holding company regulatory legislation).

S.544 seems a very modest step, albeit an important one, in proactively addressing a major airline industry holding company problem before it gets further out of hand. IFFA views this legislation as necessary to curb current abuses of an air carrier's public corporate identity and federal certificate which in turn undermine the carrier's economic life while enriching its owner's other business activities. This is particularly true in light of DOT's inclination to ignore the problem.

2. The U.S. Department of Transportation Refuses To Impose Reasonable Restriction On Airline Asset Transfers To Corporate Affiliates, Even Though It Considers Affiliate Assets In Determining Carrier Financial Fitness.

During the past year DOT has made clear that air carriers may freely transfer whatever assets they wish to their non-airline corporate affiliates without violating the Federal Aviation Act, regardless of how such transfers adversely affect creditors, consumers, employees or the public. Even though Subsection 401(r) of the Federal Aviation Act, 49 U.S.C. § 1371(r), imposes a continuing requirement upon all U.S. air carriers to remain "fit, willing, and able" at all times to perform the transportation authorized by their certificates, the TWA and Eastern employees have unsuccessfully sought DOT application of this statute to avert financial catastrophe caused by massive levels of carrier asset transfers. *See* IFFA Fitness

Petition, Tab A; ALPA Fitness Petition Re. Eastern (DOT Docket 45994). In both instances DOT refused to institute full fitness investigations despite overwhelming evidence that these asset transfers would inevitably impede the carriers' continued operational capabilities. The rights of creditors, consumers employees and the public were effectively ignored. Unless S.544 is enacted, there may be no viable way of halting these asset transfers until after a carrier is in bankruptcy, when it is far too late for adequate protection of interested parties.

Ironically, DOT appears to rely on the collective asset base of an airline's various corporate affiliates in assessing carrier fitness even though the Department refuses to require a carrier owner commitment of these assets to safeguard the carrier's financial health. For example, this Committee learned during the March 17, 1989 hearing on S.544 that DOT found Eastern Airlines financially fit in substantial part on the basis of Texas Air's other financial resources and assets. (March 17, 1989 Testimony of Farrell Kupersmith before Senate Judiciary Committee Hearing on S.544). In the TWA fitness proceeding, both DOT and TWA tried zealously to demonstrate the carrier's financial fitness by counting among TWA's airline assets a huge block of Texaco stock (and then subsequently the sale proceeds therefrom) which was actually owned and controlled by Swan

Management Company, a separately incorporated Icahn affiliate created solely for the purpose of speculating in the stock market. (Tab O).

Although TWA's owner has repeatedly assured employees, DOT, Congress and the public that assets controlled by various TWA affiliates are available for carrier operations, particularly for fleet replenishment with new aircraft, these aircraft have yet to be acquired while TWA continues operating one of the country's oldest fleets. (Tab P). Mr. Icahn has not delivered on any of his myriad promises to obtain the new planes needed for TWA's long term viability. (Tab Q). On the contrary, TWA's former president, Joe Corr, seemed so doubtful about these new planes ever materializing that he apparently resigned in part because their absence plus the stripping away of TWA's other assets crippled the carrier too much to compete. (Tab R).

S.544 provides a strong incentive for airline owners to commit resources in a manner more likely to assure long term economic viability. It also encourages far sounder management of these resources to the benefit of creditors, consumers, the public and even the owners themselves. Since DOT refuses to exercise its oversight powers in a manner consistent with achieving these results, S.544 provides a plausible legal means for doing so. An airline's unique nature renders this not only a desirable but necessary public policy, in light of the unacceptable alternatives.

3. An Airline's Unique Nature Requires That Federal Legal Principles Rather Than State Corporate Law Governed Carrier Financial Activities.

S.544 effectively pierces an airline's corporate veil to permit access to carrier affiliates' assets by creditors. Although such veil-piercing departs somewhat from state corporate law principles applicable to other businesses, an airline's unique status as a federally licensed utility clearly warrants such departure. Federal airline deregulation legislation never eliminated the status of air carriers as creatures of federal rather than state law. Moreover, the issue of relying upon the present Bankruptcy Code rooted in state fraudulent conveyance, preferences and limited liability laws to protect affected parties, as suggested to this Committee last March 17, ignores the far bigger issue of subjecting airlines to more rigorous financial performance standards than those required for other businesses.

In support of last year's TWA Fitness Investigation Petition, deregulation architect Dr. Alfred Kahn identified numerous carrier activities which were always intended to remain subject to tight federal control. (Kahn Statement, Tab S). These include, at a minimum, antitrust enforcement; consumer protection; safety; carrier fitness certification;

management of air space, traffic control, airport systems (and now landing slots); and international routes access. (Id. at 3-6, 17). The federal government even regulates carrier ticket sales through computer reservation systems. Such pervasive federal involvement requires that federal aviation and related utilities law principles rather than state corporate laws must control the debate over curbing airline corporate abuses through Bankruptcy Code reform.

Dr. Kahn correctly observes that Congress has always intended to require vigorous federal legal policing over carrier consumer abuses is especially appropriate here, since a fundamental deregulation policy objective is the protection of consumers "from significant risks created by mismanagement and/or inadequate financing if the [air service] is provided." (Id. at 8, quoting from CAB Deregulation Policy Statement, 44 Federal Register 44109 (July 26, 1979). He further noted:

> "The airlines receive large quantities of monies from travelers and have also been offering them various promotional promises-to-fly, such as frequent flyer credits, in advance of their actual travel. One important consideration supporting the government's responsibility to ensure financial soundness is the desire to protect customer from loss of these funds

> by virtue of the unwillingness or inability of an airline to fulfill these commitments.

(Id. at 13)(emphasis added).

Implicit in Dr. Kahn's observation is the notion that the airline consumer is perhaps a carrier's largest unsecured creditor class. Unlike the consumers of other goods and services, most airline consumers fully pay in advance for the transportation to be provided. The carriers in turn accept passenger monies in advance to maintain an ability to provide the service. This scheme works well as long as carriers continue to apply these funds to operations. Once carriers commit ticket revenues to collateralize excessive debt incurred for stock market speculation or other securities transactions which weaken the airline's financial structure while enriching a carrier's non-airline affiliates, however, the potential for airline consumer abuse becomes unlimited.

S.544 is essential to protect passenger creditors, whose ticket purchases effectively finance TWA stock market machinations and Eastern asset transfers by providing money which should always be required to remain with the carriers for operational use. Even if this bill limited corporate affiliate assets access solely to consumer creditors it would still warrant passage, since the vast consumer creditor class must necessarily rely upon federal legal protection well beyond present bankruptcy laws. The legislation's public benefits, however, go even beyond this worthwhile objective.

4. IFFA Has A Direct Interest In S.544 As A Potentially Sizable Judgment Creditor.

In addition to all the reasons described above warranting passage of S.544, IFFA has a direct interest in this legislation as a potentially sizable TWA judgment creditor. IFFA presently has several major lawsuits pending against TWA which arose from Carl Icahn's heavy-handed abuses in provoking the 1986 Flight Attendants strike. These claims encompass alleged bad faith collective bargaining and related unfair labor practices; class wide gender and age discrimination claims; plus willful refusals to honor its existing collective bargaining agreement. If successful, TWA's Flight Attendants could be in a position to collect several hundred million dollars in legitimate judgments against TWA. IFFA has already won a major Supreme Court decision and expects similar results in its other pending cases. The magnitude of TWA's potential liability is a major reason that IFFA opposed the TWA privatization, since execution of even some of these potential judgments could topple the financially weakened TWA into bankruptcy and thus cost Flight Attendants (plus other employees) their jobs merely for trying to enforce basic legal rights. This would occur despite the fact that assets sufficient to operate the airline and satisfy judgments are otherwise available from Icahn affiliates enriched by siphoning off TWA's airline revenues for their own unrelated uses.

Carl Icahn has not hesitated to inform IFFA and other TWA employee groups that he will take the carrier into bankruptcy himself if necessary to avoid satisfying any significant IFFA judgment. Even though he personally committed or directed most if not all the illegal acts supporting IFFA's claims against the carrier, Mr. Icahn seems to be counting on traditional corporate veil protection from liability for his own misconduct plus the very real spectre of bankruptcy to chill the Flight Attendants' quest for simple justice. Such an outcome would be little short of outrageous. If Carl Icahn is permitted to transfer airline assets, often comprised of substantial employee wage and benefit concessions, systematically out of the carrier into the coffers of his various non-airline affiliates merely to avoid satisfaction of judgments or to force an unwanted bankruptcy, other airline owners can be expected to do likewise. Within little time airline employees could no longer rely upon the courts either to protect them from illegal carrier acts or to enforce existing contractual rights at discernible cost to the carrier. Airline employee relations would inevitably revert to the law of the jungle, with precipitous decline in morale. The DOT Preliminary

Fitness Report on Eastern, while inaccurate in most regards, nonetheless correctly concluded that the direct correlation between abysmal carrier employee relations and serious carrier safety risks is obvious.

There is also a material difference between an airline's commercial creditors accustomed to dealing on an arm's length transactional basis with the attendant degree of financial risk, and employee judgment creditors who have been wronged through carrier misconduct and have little recourse except the courts or unemployment lines. S.544 offers badly needed employee protection against illegal airline owner actions by assuring that the owner's other, non-airline assets are available to compensate for the harm. The deterring effect on airline owner misconduct alone created by this legislation warrants its expeditious passage.

5. The Ban Against Unilateral Air Carrier Wages Or Working Condition Changes Also Justifies Enactment Of S.544.

As an airline employee collective bargaining representative governed by the Railway Labor Act, IFFA strongly supports the statutory codification of an important RLA principle in S.544. By assuring that airline employees cannot be subject to unilateral changes in wages or working conditions, this legislation extends rights already enjoyed by other transportation employees to the air carrier work force. The importance of collective bargaining to the airline industry in terms of trying to maintain labor peace and acceptable employee morale warrants such extension here.

6. Passage Of S.544 Attacks The Growing Airline Industry Concentration Problem By Encouraging Sounder Carrier Resource Management.

While reviewing S.544 within a Bankruptcy Code amendment context, this Committee should remain ever vigilant in its jurisdictional responsibility to halt the already unacceptable levels of anticompetitive over- concentration presently characterizing the airline industry. S.544 necessarily encourages far better resource management at all air carriers to prevent exposure of their other corporate affiliates' assets. Once such assets become available to all creditors in bankruptcy proceedings, carrier owners will ostensibly make much greater effort to avert bankruptcy altogether by increasing and more efficiently managing carrier resources. This in turn could notably stimulate greater competition by improving weaker carrier health. Given today's serious industry concentration problems, the resulting public benefits could be substantial.

Passage of S.544 might also serve to discourage further airline merger mania by stopping dead in their tracks anti-competitive acquisitions such as the widely ballyhooed Icahn acquisition of Eastern. This particular acquistion is of course objectionable under any circumstances absent enactment of S.544 to prevent yet further Icahn asset-milking such as that described above. At a minimum, the availability of affiliate assets to some of the industry's weaker carriers such as TWA helps assure their survival and continued presence in today's oligopolistic market.

7. Concluding Comments

For all the foregoing reasons, IFFA enthusiastically supports S.544 and urges its immediate enactment. The TWA Flight Attendants stand ready to help bring about the badly needed airline industry changes likely to result.

The Independent Federation of Flight Attendants has submitted additional exhibits supporting S. 544. These exhibits can be viewed in the Senate Subcommittee on Antitrust, Monopolies and Business Rights, 308 Hart Senate Office Building

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In Re: EASTERN AIR LINES, INC., Debtor.	Chapter 11 Case No.: 89 B 10449 (BRL)

DECLARATION OF FARRELL P. KUPERSMITH

I, Farrell P. Kupersmith, do hereby declare under penalty of perjury that the following is a true statement to the best of my knowledge, information and belief:

1. I am Associate Managing Partner of the Firm of Touche Ross & Co. and as such am also a Partner in the Firm. Touche Ross & Co. is a member firm of Touche Ross International, one of the world's largest professional services organizations. It has operations in 87 countries and employs more than 30,000 persons. The Firm's professionals provide accounting, auditing, tax, and management consulting services to clients in the public, not-for-profit, and private sectors.

2. I am a member of the Firm's Management Committee, which is responsible for the management activities of the Firm. I am also a member of the management consulting function's Management Committee, which functions as the Board of Directors for the Firm's management consulting operations.

3. Until 1987, I was the Managing Partner of Touche Ross' Reorganization Advisory Services (RAS) Group. As Managing Partner of the RAS Group, I was in charge of all services provided to parties-in-interest in troubled business situations in the United States. These services encompassed financial reorganizations, both in and out of formal court supervised proceedings. Engagements in which the Firm's RAS Group played a prominent role include: Braniff Airways, Air Florida, Continental Airlines ("Continental"), Storage Technology, LTV Steel, Wheeling-Pittsburg Steel, McClouth Steel, Pantry Pride, Jartran, Bobbie Brooks, Roberts and Porter, Saxon Paper, Continental Illinois Bank, Penn Square Bank, Buttes Gas and Oil, and many others. Over the past several years, the RAS Group has actively participated in the recapitalization and restructuring of more than $25 billion of liabilities. The RAS Group has also participated in the renegotiation and restructuring of sovereign debt. As the Managing Partner of RAS, I was responsible for review and approval of the opinions expressed by the Firm in addition to having overall responsibility for quality assurance, engagement acceptance, staffing, and direct supervision of other Partners operating in the RAS practice area.

4. In addition to my responsibilities as a member of the Firm's Management, Strategy, and Capitalization committees, I am the Chief Executive Officer of Touche Holdings. Touche Holdings is a wholly-owned subsidiary of the Firm, created for

the management of partner and Firm capital, dedicated to wealth building investment opportunities.

5. The majority of my professional career has entailed evaluating companies and their strategies, their management, their potential, their plans, their capital structures and their cash flows. In addition, my professional activities have encompassed the evaluation of various securities that represent vehicles both for the settlement of liabilities and/or recovery of debt in the reorganization advisory context as well as for new investment.

6.- Specific airline reorganizations in which I have personally participated include: Braniff, Air Florida and Continental Airlines. I have also conducted analytical assignments for investment groups involving TWA, Pam Am, People's Express, Eastern, Northwest, Republic and Texas Air. I was the Partner responsible for all of the Firm's services relating to the Continental Airlines Chapter 11 reorganization which encompassed more than 28,000 man-hours with active participation on behalf of the formal court appointed Official Creditors' Committee, as well as direct monitoring of the Company's reorganization activities for the court itself. I have been responsible for my Firm's assignment at Eastern which has included comprehensive monitoring and analysis of Eastern since January 1988 on behalf of the Air Line Pilots Association ("ALPA").

7. I testified many times as an expert in the Continental Airlines Chapter 11 reorganization proceeding, including the trial initiated by labor groups ALPA, the International Association of Machinists ("IAM"), the Transport Workers Union ("TWU") and the Union of Flight Attendants ("UFA") to dismiss the bankruptcy petition as a bad faith filing. In the trial, I testified against the Unions' motion, at Continental's request and with the consent of the Official Creditors' Committee, as to the financial condition of Continental Airlines and the validity of its bankruptcy petition. Frank Lorenzo was CEO of Continental at the time.

8. I have testified as an expert and have been consulted in numerous other situations and proceedings, including the following matters related to Eastern Airlines:

a. Air Line Pilots Ass'n Int'l v. Eastern Air Lines Inc., 129 L.R.R.M (BNA) 2644 (D.D.C. 1988) (Parker, D.J.) (action to enjoin downsizing and furloughs proposed by Eastern for fall, 1988). ["Fall Downsizing Proceedings"]

b. Air Line Pilots Ass'n, Int'l v. Eastern Air Lines, Inc., Nos. 87-2001, 88-0364, 88-0870, slip op. (D.D.C. Dec. 19, 1988) (Parker, D.J.) (action to enjoin sale of shuttle to Donald Trump. ["Shuttle Proceedings"]

c. In the Matter of Eastern Air Lines, Inc., Continental Air Lines, Inc. and the Texas Air Corp., National Mediation Board, Case Nos. CR-6053 et seq. (proceeding to have Eastern and Continental declared a "single carrier" for purposes of the Railway Labor Act) ["NMB Proceedings"]

d. Department of Transporation ("DOT") 1988

Examination prior to their Fitness Review of Texas Air and its subsidiaries (consultation)

9. The conclusions in this declaration reflect my cumulative experience through direct participation in, and supervision of, the work on this project and on other relevant projects. Together these efforts encompass tens of thousands of hours of work.

10. This declaration is based on analysis using publicly available information on Eastern Air Lines, Continental Airlines and Texas Air. Many of these sources are identified below with abbreviated descriptions, as they will be identified in citations throughout this document:

a. SEC filings of Jet Capital Corporation ("Jet Capital"), Texas Air Corporation "(Texas Air"), Eastern, Continental, People Express and other major carriers;

b. Testimony in Federal District Court from the Fall downsizing proceedings;

c. Testimony in Federal District Court from the Shuttle proceedings;

d. The DOT Report on the DOT fitness investigation of Texas Air and its subsidiaries, entitled "Report to the Secretary, Preliminary Investigation of

Texas Air Corporation and its Subsidiaries Docket 45581" (Cited herein as "DOT Fitness Report"); and

e. Testimony and submissions in the NMB Proceedings.

11. This Declaration describes how Texas Air has implemented an overall strategy to strip key component parts from Eastern Air Lines for the purpose of transferring those assets to the rest of the Texas Air family. It details the significant asset stripping activities and dismantling that we have identified in the course of our analysis.

12. Specifically, I have prepared this Declaration in support of ALPA's petition to the Bankruptcy Court, under Bankruptcy Code Section 1104(a), to appoint a Trustee of Eastern Air Lines. I believe that such an action is warranted because:

a. Eastern management is controlled and dominated by Frank Lorenzo and Texas Air through an interlocking directorate, and through the installation of managers in positions of authority at Eastern Air Lines who owe their allegiance to Texas Air and Frank Lorenzo. Lorenzo-directed management has not acted to benefit Eastern in the past, and will not investigate, attempt to recover, or litigate highly questionable transactions that have occurred between Eastern and its affiliates. A successful challenge to these transactions would constitute a substantial threat to Texas Air, Frank Lorenzo, and themselves;

b. Since being acquired by Texas Air, Eastern management has executed numerous transactions with its affiliates that have diminished the value of Eastern while enriching sister subsidiaries (e.g., Continental) and the parent company, Texas Air;

c. Texas Air (with the cooperation of Texas Air controlled management at Eastern and Continental) has stripped Eastern of significant market share by causing Eastern to drop service and Continental to assume Eastern's service; and

d. Even as a plan to bring about a financial recovery for Eastern, although no business plan now exists, stripping EAL of valuable assets constitutes, at a minimum, gross mismanagement and incompetence. Either a sophisticated asset stripping scheme is underway or management is incompetent. In either event, entrusting Texas Air controlled management with reorganizing under Chapter 11 would harm the Estate, its creditors, preferred shareholders, and employees.

This declaration discusses these issues in detail, illustrating how Texas Air and Eastern management have not, and will not, act in the best interests of Eastern Air Lines.

INTERLOCKING DIRECTORATES AND MANAGEMENT ALLEGIANCE

13. Texas Air took control of Eastern in November 1986 by purchasing 100% of the stock of Eastern. Although Texas Air is the only common shareholder, Eastern has four classes of preferred shareholders, none of which are exclusively owned by Texas Air or any other affiliated company.

14. Texas Air operates Eastern and Continental, two of this country's ten major air carriers. Only one of its carriers, Continental, is non-union. Through Eastern and Continental, Texas Air controls one of the largest market shares in the industry. Unlike its merging of People Express, Frontier, and New York Air into Continental, Texas Air apparently determined that it was not in its best interest to merge Continental and Eastern. Instead, Texas Air has declared that Continental and Eastern are separate carriers, which has preserved Continental's non-union status. However, to obtain many of the synergies of a combined entity without actually

merging the companies, Texas Air has stripped and transferred assets from Eastern to Continental and other Texas Air subsidiaries.

15. Asset stripping at Eastern has taken place under the direction of Eastern's Board of Directors and management. Eastern's Board of Directors is controlled by Frank Lorenzo and Texas Air through an interlocking directorate which includes directors chosen because of their close association with Frank Lorenzo. Similarly, Eastern's management was put in place and is controlled by Frank Lorenzo.

16. Mr. Lorenzo, as reported in the 1987 Texas Air Proxy Statement, has stock ownership which entitles him to exercise 45.9 percent of the general voting power of Jet Capital Corporation ("Jet Capital"), which has 34% voting control of Texas Air. In its SEC filing, Texas Air acknowledged that it is controlled by Jet Capital [1988 TAC Proxy, pp. 3-6 (Ex. 1)[1]]. Texas Air, in turn, has 100 percent stock ownership and control of its subsidiaries.

17. Frank Lorenzo controls the Boards of Directors of Jet Capital, Texas Air, Continental, and Eastern. Exhibit 2, which identifies the Board members, illustrates how Mr. Lorenzo exerts control; it also identifies the Board members of the four

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[1] All exhibits referred to herein are contained in a separate volume submitted herewith.

major corporate entities in Frank Lorenzo's control. The top half of the chart identifies Lorenzo's closest associates. Shading indicates that the Board member was, at some time in his career, a member of the associated Company Board; a "C" in addition to shading indicates that the individual is currently a Board member of the company specified. Exhibit 2 was prepared under my direction for the NMB proceedings on May 25, 1988. Since that time, there has been additional movement among Texas Air's directors and executives. Many of these changes are described in the footnotes of Exhibits 2 and 5. [NMB Proceedings, May 25, 1988, "Interlocking Directorships" (Ex. 2)].

18. All of the individuals identified as holding "Multiple Director Positions" are long time associates of Mr. Lorenzo, as illustrated below, and current members of Texas Air's Board. Additionally, Mr. Pohlad and Mr. Wilson are members of Jet Capital, Eastern, and Continental's Boards of Directors. [TAC 1988 Proxy, pp. 4-6 (Ex. 2)].

LONG TIME ASSOCIATES OF FRANK LORENZO

Director	Type of Original Association	Start of Association
Mr. Pohlad	Texas Air Director	1967
Mr. Wilson	Texas Air Director	1976
Mr. Snedeker	Jet Capital Director	1971
Mr. Carney	Harvard Business School and Jet Capital	

19. The remaining members of Texas Air's Board are also trusted associates of Mr. Lorenzo through their long-standing association with Texas Air. Additionally, Mr. Borman, President of Eastern at the time of Texas Air's purchase of Eastern, negotiated a financially lucrative severance agreement with Mr. Lorenzo prior to Texas Air's formal acquisition of Eastern in 1986.

20. Eastern's Board consists of five carryover Eastern Board members and eight Texas Air/Eastern appointments. The six Lorenzo nominees, identified in Eastern's 1987 10-K filing, are long-time Texas Air/Lorenzo associates. In addition to Frank Lorenzo, Lorenzo controlled Directors include:

a. Mr. Pohlad, who has served as an Eastern director since January 1987. Mr. Pohlad is a director of Texas Air (since 1967), Continental (since March 1982), and Jet Capital (since March 1986);

b. Mr. Wilson, who has served as a director of Eastern since January 1987. Mr. Wilson is also a director of Texas Air (since 1976), Continental (since March 1982) and Jet Capital (since March 1987);

c. Mr. Snedeker, who has served as a director of Eastern since January 1987. At Texas Air, he is a director (since July 1982) and the Senior Vice President and Treasurer (from June 1980 to December 1981 and since July 1982). Mr. Snedeker is also the Secretary, Treasurer, and director of Jet Capital (since 1971);

d. Mr. Bakes, who has served as a director of Eastern since October 1986, before Texas Air completed its acquisition of Eastern. Mr. Bakes is also Eastern's President and Chief Executive Officer. Mr. Bakes previously served as a director (from August 1980 to November 1982) of Texas Air; as director (from 1982 to October 1986), President (from April 1984 to October 1986), Executive Vice President (from September 1983 to April 1984), and Senior Vice President (from March 1982 to September 1983) of Continental;

e. Mr. Leonard, who has been a director of Eastern since September 1985. Mr. Leonard is currently employed by Eastern as Senior Vice President for Operations. Mr. Leonard negotiated an attractive employment and severance agreement upon Texas Air's acquisition of Eastern;

f. Mr. Fox, who has been a director since December 1987. Mr. Fox served as Chairman of Continental's International Advisory Board from November 1984 to November 1987. [EAL 10K, December 31,1987, pp. 62-67 (Ex. 3)].

21. In June 1988, Mr. Foret was elected to Eastern's Board. Mr. Foret joined Eastern in October 1986. He was Vice President-Finance and Chief Financial Officer from October 1986 to November 1987 when he became Senior Vice President-Finance and International. Prior to joining Eastern, he served as Vice President and Treasurer (from August 1982 to April 1984) and as Vice President-Finance and Chief Financial Officer (from April 1984 to October 1986) of Continental. Mr. Foret was recently moved back to Continental and is currently an executive Vice President of Finance and Planning at Continental and on the Board of Continental. This was confirmed to a member of my staff by an "Assistant to Mr. Foret" at Continental, who also stated that Mr. Foret is no longer on the Board of Eastern. [NMB Proceedings, May 25, 1988, "Interlocking Directorships" (Ex. 2)].

22. While Eastern claims it is operating independently with its own Board of Directors, there should be no doubt about Mr. Lorenzo's real influence. Mr. Taylor, one of Eastern's five "independent" Directors, has made it clear that Board members serve at the pleasure of Texas Air and Frank Lorenzo. In

testimony on December 9, 1988, Mr. Taylor was asked whether Eastern's Board could "hire and fire Mr. Bakes at will." Mr. Taylor responded:

> Technically the Board could but if the shareholder [Texas Air] disagreed with that, there might be a new Board. [Shuttle Proceedings, December 9, 1988, Taylor Testimony, p. 1522 (Ex. 3)].

23. In addition to controlling Eastern's Board, Mr. Lorenzo controls the senior management of Texas Air, Continental, and Eastern. The majority of Eastern's most senior executives have previously held positions with Texas Air and/or Continental at some point in their careers, and are regularly moved throughout the Texas Air empire as described in Exhibit 5 [NMB Proceedings, May 25. 1988, "Executive Transfers Among Texas Air Entities" (Ex. 5)]. Mr. Bakes and Mr. Foret, both directors, are two leading examples of the way that Texas Air moves its senior executives around to exercise control of its subsidiary operations.

24. The executive transfers among Texas Air entities are illustrated in Exhibit 5. All of the executives named currently hold a position of President, Senior Vice President, Chief Executive Officer, or Chief Financial Officer at one of the three entities. The chart demonstrates how Frank Lorenzo has installed his closest advisors as top management of Eastern. As of March 1988, seven of the twelve key past or present Eastern executives who appear in Exhibit 5 have also been with at least

one other Texas Air entity during their careers. Since that date there has been additional movement of executives, including Mr. Nelson and Mr. Foret, who have moved from Eastern to Continental. The movement of senior executives within the Texas Air empire, between 1982 and 1987, is summarized below. Associations prior to 1982 are not included because they were not reported in Eastern's 1987 10-K filing.

a. Mr. Barry Simon -- joined Eastern in November 1987 as Senior Vice President - Legal Affairs and Administration, General Counsel and Secretary. Prior to joining Eastern, he served as Vice President-International Operations (from February 1987 to November 1987) of Continental; as Senior Vice President (from September 1986 to February 1987) of Texas Air; and as Vice President, General Counsel and Secretary (from 1982 to September 1986) of Continental.

b. Mr. Tom Matthews -- joined Eastern in June 1987. He is currently Senior Vice President-Human Resources at Eastern. Mr. Matthews was with Continental from January 1982 to November 1983 at which time he was Continental's Senior Vice President-Employee Relations.

c. Mr. John Adams -- became Senior Vice President - Human Resources at Continental in June 1987. He was Vice President-Human Resources of Eastern from October 1986 to June 1987. From September 1985 to October 1986, he was Vice President-Personnel of Continental. In addition, at the time Frank Lorenzo attempted to purchase TWA, Mr. Adams was dispatched by Texas Air to TWA and returned several weeks later, after Carl Icahn obtained control of the carrier.

d. Mr. Donald Breeding -- joined Eastern in July 1986 as Vice President-Flight Operations. Prior to joining Eastern, Mr. Breeding served as Vice President-Flight Operations (from August 1982 to July 1986) at Continental.

25. Aside from their long-standing relationships with Frank Lorenzo and Texas Air, the compensation of Eastern's executives is largely based on the performance of Texas Air, not Eastern -- all own Texas Air stock or have Texas Air stock options. [TAC Form 8, April 28, 1988, p. 9 (Ex. 6); EAL 10K, December 31, 1987, pp. 63-70 (Ex. 7); CAL 10K, December 31, 1988, pp. 55-62 (Ex. 8)]. All of these facts demonstrate that Eastern's key executives are not working for the benefit of Eastern's creditors and shareholders but to the advantage of

Texas Air, and ultimately Jet Capital and Frank Lorenzo. Thus, Mr. Bakes testified:

Question:	Isn't it a fact that you believe that there need not be an Eastern Air Lines for Texas Air's stockholders to make money?
Bakes:	Under certain circumstances, that could be the case.
Question:	And that has been a stated position of yours, has it not?
Bakes:	Under certain circumstances, yes, I agree with that.
Question:	...you have also stated publicly that unless the cost structure at Eastern Air Lines is reduced, that there is some question as to whether assets will be transferred to other entities, isn't that correct?
Bakes:	I have said that. [Fall Downsizing Proceedings, August 19, 1988, Bakes Testimony, p. 79 (Ex.9)].

26. Because the same interlocking directorate manages and controls both Continental and Eastern, a conflict of interest exists since Texas Air's Board and management make strategic, operational and financial decisions for both Continental and Eastern. The makeup of Eastern's Board of Directors and senior management team shows that allegiance of Eastern's Board and management is not to Eastern but to Texas Air. Clearly, the Texas Air entities are not independent when Texas Air controls and moves executives and directors in this manner. Further, the two carriers, like other major carriers in a competitive deregulated environment, should be fierce competitors. This is not possible when management of the

different carriers are interchangeable and/or serving both corporations.

27. This conflict of interest has been manifested both at the Board level and in the daily management of the carriers ever since Texas Air took control of Eastern. According to Eastern's internal planning documents presented in court, Continental, Eastern, and Texas Air management met regularly to plan pricing and route structures and to address other operational issues. Attached to this Declaration as Exhibit 10 is a memo prepared by Phil Bakes and addressed to both Eastern, Texas Air and Continental managers. The memo requests the group to put an agenda together for planning and pricing meetings at which "immediate issues 'conflicting' between entities," "longer term strategic -- who flies where," and "how we should price seats" are discussed. [Bakes Internal Memo, October 21, 1986 (Ex. 10)].

28. Because of the interlocking management, Board structure, and incentive schemes, Eastern management cannot and will not, at its own behest, actively investigate, attempt to recover, litigate, and act concerning highly questionable transactions that have occurred between Eastern and its affiliates. Thus, it will not exercise its fiduciary responsibility and act in the best interests of Eastern. Many of these questionable transactions are the result of the asset transfer scheme. The same management that initiated and is

responsible for executing the transactions prior to filing for protection with this Court cannot investigate and unwind those same transactions for the benefit of Eastern's creditors, employees, preferred shareholders, and other constituencies.

ASSET STRIPPING ACTIVITIES AT EASTERN

29. Since its acquisition of Eastern in 1986, Texas Air has engaged in a strategy to transfer Eastern's choicest assets to Texas Air and other non-union affiliates. Eastern has executed this strategy under the guise of needing to improve liquidity. Senior Texas Air and Eastern management, as well as their expert witnesses, emphasized Eastern's dire need for liquidity. They proffered the need for liquidity as the justification for asset sales.

30. Eastern's expert witness in several hearings, Mr. David Kasper, stressed Eastern's need for liquidity:

> a. I believe that Eastern would be far better off, far more prudent if they would double their liquidity balances to ...twice their current levels.
>
> [Shuttle Proceedings, December 7, 1988, Kasper Testimony, p. 963 (Ex. 11)].
>
> b. ...if it does not do something to sure up that liquidity, then it will not be a viable airline.
> [Shuttle Proceedings, December 7, 1988, Kasper Testimony, p. 968 (Ex. 11)].

31. During the same period that Eastern management was selling assets, purportedly, to raise cash, it was seriously diminishing the value of Eastern while enriching its affiliates, including Continental and Texas Air. Eastern management has engineered the transfer of value by:

a. Selling Eastern assets and services for less than they are worth;

b. Financing the sale of Eastern assets and receiving substandard credit instruments that are not marketable;

c. Purchasing assets and services from Texas Air and its affiliates for more than they are worth and purchasing unnecessary assets and services; and

d. Making operating decisions that enhance the interests of Texas Air and its other subsidiaries at the expense of Eastern (i.e., withdrawing or curtailing service from Eastern markets which are then served by Continental.)

e. Lending cash to affiliated companies.

32. Texas Air and Eastern management have cited the DOT Fitness Report, completed on May 25, 1988, as evidence that inter-company transactions between Eastern and Texas Air

represent no cause for concern. However, the DOT explicitly stated that it did not attempt to evaluate the "wisdom" of the transactions. Thus, the DOT report stated:

> In examining developments and decisions of Texas Air and its two air carrier subsidiaries in this area [financial fitness], we have not attempted to assess the wisdom of business decisions per se.
>
> [DOT Fitness Report, May 25, 1988 p.5 (Ex. 12)].

33. The DOT Report further clarifies that it did not review the impact of various transactions on the individual carriers:

> We have attached as Appendices 323-324 more detailed discussions of these transactions in order to facilitate assessment of whether they may affect the individual companies favorably or unfavorably. Further, we do not see a basis for concern over where in the Texas Air organization particular assets are held, provided that the location of an asset does not affect the ability of the carriers to maintain safe operations.
>
> [DOT Fitness Report, May 25, 1988, p. 57 (Ex. 12)].

34. In a private discussion with then Assistant Secretary for Policy and International Affairs for the DOT, Matthew Socozza, Mr. Socozza stated that he was not concerned about the effect of the transactions on Eastern alone, but that he would be extremely concerned by the transactions if it came to pass that Eastern could not meet its obligations. In other words, the Department's perspective when it prepared its Report and findings was of a single corporate entity whose financial

obligations were, in essence, guaranteed by Texas Air as if it were one entity. The DOT Report reflects Mr. Socozza's point as follows:

> Because it is a holding company, Texas Air can shift resources among its companies for them to meet their financial and other commitments; thus Eastern's and Continental's shortfalls would not necessarily threaten either their viability or their safety of operation -- provided Texas Air has the commitment and resources to assist them.
>
> [DOT Fitness Report, May 25, 1988, p. xiii (Ex. 12)].

35. In fact, Texas Air, the "holding company," has "shift[ed] resources" primarily out of Eastern and into other Texas Air subsidiaries. Furthermore, in a bankruptcy setting, the location of those resources does matter because Texas Air has guaranteed few of Eastern's obligations.

36. Compelling evidence demonstrates that the professed need for liquidity is a cover for the stripping of assets from Eastern and the transfer of these assets to other parts of Texas Air at less than their full value. Detailed evidence of the asset stripping scheme is provided below.

Eastern did not demand its $16 million due on demand receivable from Texas Air for almost two years, and did so only after major embarrassment in Federal District Court when Eastern President, Phil Bakes, testified that he was not aware that the obligation was payable on demand and that the transaction was "very complicated."

37. In November 1986, Eastern accepted a $16 million, non-interest bearing "due on demand" receivable in lieu of cash

that Texas Air had agreed to pay Eastern as reimbursement for certain merger-related expenses. Eastern officials have argued that the $16 million was not a real obligation but rather an accounting maneuver (Ex. 13, pp. 81-82) -- yet they recorded this obligation on their books and records as a realizable asset and distributed these financial statements to the public and the SEC. Thus Eastern's public position was contradicted by its independently certified financial statements.

38. Eastern held this non-interest bearing receivable almost two years without requiring Texas Air to pay the $16 million which it was legally entitled to receive on demand. Eastern's "independent" management had not made demand even though the need for funds was the justification for the proposed sale of the Eastern Shuttle. The receivable cost Eastern approximately $2.8 million per year in foregone interest earnings based on its latest borrowing rate at the time. Yet, Eastern's President, Mr. Phil Bakes, testified that he did not know whether the $16 million receivable from Texas Air paid interest and that it was a "very complicated" transaction. [(Ex. 13) p. 81)] Eastern made demand on Texas Air only after Courtroom questioning raised it as an issue. In contrast, Texas Air demanded immediate payment of fees and expenses from Eastern, amounting to $4.8 million, relating to the failed affiliate Shuttle transaction. The agreement was terminated in

July, 1988, and the entire amount was collected by Texas Air as of September 30, 1988. Of the total that Texas Air collected, $1.25 million was paid by Texas Air to Jet Capital for its services in connection with the transaction.

Eastern loaned Continental $40 million, and in the concurrent time frame, applied for a $105 million pension waiver.

39. In the Spring of 1988, Eastern loaned Continental $40 million, payable on demand over a 120 day period. The loan had an annual interest rate of 17.5 percent and a final maturity of two years. The loan was secured with assets of Continental which Eastern President Phil Bakes was unable to identify when questioned about the transaction in the Fall Downsizing proceedings. [Fall Downsizing proceedings, August 17, 1988, Bakes Testimony p. 35 (Ex. 56)]. Indeed, Mr. Bakes emphasized the special nature of the $40 million loan to Continental:

> This was a loan to not just any company that rang our doorbell, we don't consider ourselves a bank necessarily, but it was a company that we had obviously very close relationships with ...
>
> [Fall Downsizing Proceedings, August 17, 1988, Bakes Testimony p. 33 (Ex. 56)].

In the concurrent time frame Eastern sold assets to increase liquidity and applied for a $105 million pension contribution waiver from the Internal Revenue Service. [EAL 10Q, September 30, 1988, p.9 (Ex. 14)].

Mr. Taylor, a member of Eastern's Board of Directors, was asked about the $40 million loan during the Shuttle proceedings:

Question:	Is there a critical need for liquidity at Eastern Air Lines today?
Taylor:	Yes.
Question:	Would it be prudent in your judgment to begin to demand the repayment of that $40 million loan which is not receivable in full until approximately 120 days hence, wouldn't it be prudent to make that demand today, Mr. Taylor?
Taylor:	I can't tell you it is prudent today, but it might be prudent tomorrow.

[Shuttle Proceedings, December 9, 1988, Taylor Testimony pp. 1511-1512 (Ex. 15)].

Eastern Purchased an unmarketable, 10 percent, unsecured People Express note for $25 million in cash from Texas Air, generating a $4.4 million profit for Texas Air.

40. In March, 1987, Eastern purchased from Texas Air a note issued by nearly bankrupt People Express. The note due in 2001, had a face value of $30 million. Eastern paid Texas Air $25 million in cash for the note; Texas Air earned a $4.4 million profit on its sale of the note to Eastern. [EAL 10K, December 31, 1987, p. 48 (Ex. 16)].

41. People Express' notes and certificates, as indicated in the February 1987 edition of the Standard & Poor's Bond Guide, carry no rating. The purchase of this

note by Eastern was an irrational investment not only because of the lack of credit worthiness of People Express, but because Eastern, according to its management, desperately needed liquidity.

42. To place the transaction in perspective, if the note did not have a fair net realizable value, Eastern should not have entered into the transaction. If the note were truly marketable, Texas Air should have sold the note in the capital markets to a third-party investor, thereby generating the same cash as it had generated by selling the note to Eastern -- Eastern, in turn, would have the cash in hand and might avoid having to sell income generating assets, such as the Shuttle or aircraft, to raise cash. Eastern could then have invested the cash in high quality, highly liquid investments such as Bank Certificates of Deposits or Treasury Bills. Further, by taking the risk of a note due in 2001, Eastern has assumed interest rate risk. This risk, unfortunately, has been realized, producing a 20% decline in value since the note was purchased by Eastern from Texas Air.

Eastern funded Continental's purchase of Bar Harbor and entered into a series of financial transactions that, as of September 30, 1988, have cost Eastern $21.1 million in cash.

43. In late 1987, Eastern financed Continental's ownership of Bar Harbor at an interest rate substantially less than Eastern's own borrowing costs and with a junior creditor position. Although Eastern management alleges that there is

economic justification and benefit to Eastern from the transaction, Continental is the equity owner of Bar Harbor (now known as "Continental Express") and Eastern has no current equity stake. As of September 30, 1988, the Bar Harbor transactions have cost Eastern $21.1 million in cash. [EAL 10Q, September 30, 1988, p. 10 (Ex. 17)].

44. In effect, Eastern assumed the credit risk of the Bar Harbor loans. Yet, if Bar Harbor prospered and became profitable, Continental retained the option rights to take over the Eastern note which included conversion rights. [EAL 10K, December 31, 1987, p. 48 (Ex. 18)].

45. The Bar Harbor transaction is typical of Texas Air's asset stripping scheme:

a. Cash poor Eastern acted as "banker" for Continental; and

b. Eastern, in effect, paid for 100 percent of Continental's equity investment in Bar Harbor.

Eastern paid $22.5 million to Continental for its agreement to provide strike-related services, and incurred $19 million for 419 Continental pilots and 600 Continental flight attendants just for being available to operate Eastern's aircraft in the event of a strike through the first nine months of 1988.

46. In December 1987, Eastern paid a $22.5 million fee to Continental for nothing more than Continental's agreement to provide strike-related services. This fee was not intended to

cover actual services provided [EAL 10K, December 31, 1987, pp. 48-49 (Ex. 19)]. Eastern then paid Continental $19 million through the third quarter of 1988 for, according to the contract:

a. 419 Continental pilots, with the provision that these pilots be available to operate Eastern's aircraft on demand

[Fall Downsizing Proceedings, August 30, 1988, Judge Parker's Memorandum Opinion and Judgement, p. 15 (Ex. 20)].

b. 600 flight attendants, with the provision that these flight attendants be available to operate Eastern's aircraft on demand

["Aircraft Lease Option," Shuttle Proceedings, December 31, 1988, Plaintiff's Exhibit no. 11, pp. 1-21 (Ex. 21)].

c. The training of designated Continental pilots and flight attendants on Eastern equipment; and

d. Continental having the option to lease Eastern's aircraft and then to "wet lease" (i.e., lease with crew) the aircraft back to Eastern. (Ex. 21).

[EAL 10Q, September 30, 1988, p. 10 (Ex. 17)].

47. In addition, in the event of a strike, Eastern was liable to reimburse Continental for Continental's estimated net cost of providing strike services. (Ex. 19).

Eastern paid approximately $91 million in preferred stock dividends in 1987 and 1988 to avoid payment of additional stock which, if issued, would have been issued with a Texas Air guarantee.

48. Eastern's cash dividend payments amounted to $91 million in 1987 and 1988, during the very period that Eastern was selling assets to raise liquidity [EAL 1987 10K, pp. 31-32 (Ex. 22); EAL March 31, 1988 10Q, pp. 6-7 (Ex. 23)].

49. In testimony, on December 9, 1988 , Mr. Taylor, a Director of Eastern was asked whether he thought it "prudent for a financially troubled company to make cash dividend payments...?" Mr. Taylor responded, by saying: "Let me tell you why it is prudent. Eastern today is like a bank. There is a run on the bank, and when you don't pay the dividends or let your depositors take out their deposits, the bank comes tumbling down..." [Shuttle Proceedings, December 9, 1988, Taylor Testimony, p. 1516 (Ex. 24)].

50. Mr. Taylor did not mention that failure to pay dividends in cash was NOT a breach of the investment contract and that in fact, Eastern, at its sole discretion, could pay these dividends by issuing additional shares of stock. In the period immediately prior to his testimony, three of the four

classes received Payment in Kind dividends rather than cash. Payment in kind dividends refers to stock issued in lieu of cash dividends. It is also known as PIK stock. The class of preferred stock on which Eastern continued to pay cash dividends was the junior class of preferred stock that was guaranteed by Texas Air Corporation. If Eastern, using its discretion, were to have issued PIK stock in lieu of a cash dividend, Texas Air would be the guarantor on the new stock issue, as it was on the original junior preferred issue. In the event that Eastern missed a dividend payment in its entirety (i.e. under bankruptcy circumstances), Texas Air would be liable for the additionally issued PIK stock as well as the original merger preferred shared outstanding. [EAL/TAC Proxy Statement-Prospectus, October 15, 1986, Annex F-2, pp. 47, 48, 51-53 (Ex. 25]))].

> Eastern issued $200 million in second mortgage debt in March 1988. Although Texas Air guaranteed up to two years of interest payments, the market demanded a 17.25 percent rate of interest from Eastern; Texas Air required Eastern to deposit $40 million as security for the guarantee.

51. The only known instance in which Texas Air has voluntarily stood behind any of Eastern's financial obligations (other than the original merger preferred stock that Eastern issued to finance Texas Air's purchase of Eastern), relates to Eastern's $200 million debt issue in March 1988. In order to sell the issue, Texas Air agreed to guarantee some of the interest payments. However, in return Texas Air required Eastern to advance $40 million as partial security for the guarantee.

even though Texas Air's guarantee is limited to only two years of the five year term with Texas Air. Furthermore, Eastern's $40 million is not set aside in a special escrow account but rather is commingled with other corporate funds available to Texas Air for use at its discretion. Eastern's deposit will only earn interest at a money market rate; in discussion with Phil Bakes, he indicated that he was "not familiar with" the interest rate that Eastern is being paid on the $40 million deposit.

52. Although Texas Air, on the surface, is assuming a credit risk of $69 million, netted against the $40 million Eastern put on deposit, Texas Air actually assumed an initial credit risk of only $29 million. Since interest earned stays on deposit with Texas Air and is added to the initial deposit as additional security, the amount that Texas Air is at risk will be reduced substantially over Eastern's five year loan.

53. The hidden benefit to Texas Air is that Texas Air has access to Eastern's $40 million at a 7% to 10% lower interest rate than its actual borrowing costs would otherwise have been from third party lenders of capital. In essence, Eastern is subsidizing Texas Air. Based on the terms of a $100 million note that Texas Air borrowed in September 1988 that has a maturity of between 2.5 to 5 years (at Texas Air's discretion), Texas Air's borrowing rate will be between 16% and 20%, by contrast. Furthermore, Eastern's credit risk on this deal, since the funds are commingled and not escrowed, is $40 million plus accrued

interest, compared to Texas Air's credit risk of just $29 million plus accrued interest. [TAC 10Q, September 30, 1988, p. 11 (Ex. 26); EAL 10Q September 30, 1988, pp. 9, 10 (Ex. 27); EAL 10Q, March 31, 1988, p. 8 (Ex. 28)].

On January 1, 1987, Eastern and Continental formed Continental-Eastern Sales, Inc. (CESI). Although each airline was given 50% ownership in CESI, the agreement favored Continental, which overnight gained a large, well established distribution network.

54. The "Subscription Agreement" between CESI, Continental, and Eastern states that joint ownership would maximize benefits to both Eastern and Continental. However, the CESI contract significantly favored Continental because Eastern brought to CESI 166 sales offices compared to the 27 sales offices brought in by Continental -- and Eastern's offices are mostly located in the highly populated Northeast where Continental has dramatically expanded through its People Express acquisition. [EAL Falcon, Volume 26, Number 5, June 24, 1987, p. 3A (Ex. 29)]. Conversely, most of Continental's sales offices are located in markets where Eastern has little or no presence and therefore are of little benefit to Eastern.

55. The Department of Transportation reviewed the CESI operation and noted:

a. The costs of CESI are shared by Continental and Eastern, and the DCAA auditors determined that the allocation of costs between users appears to be on a rational and acceptable basis. [DOT Fitness Report, Volume 1, May 25, 1988, p. 61 (Ex. 12)].

> b. ....This [the CESI cost allocation] worked especially to the advantage of Continental, since Eastern had a much larger marketing force. [DOT Fitness Report, Volume 1, May 25, 1988, p. 61 (Ex. 12)].
>
> c. A sample transaction indicates that Eastern has overfunded CESI by $7.6 million for promotions. This was evidenced by payments due to Eastern from Continental. Apparently, when Continental is in a cash bind, Eastern provides funding which will be subsequently reimbursed by Continental. A copy of the reconciliation sheet was requested from Eastern; however, Eastern counsel asserts it could not be provided to the auditor. [DOT Fitness Report, DCAA Appendix 6c, p. 69 (Ex. 12)].

56. The December 12, 1988 edition of the Aviation Daily noted that "Continental and Eastern are dissolving their two-year joint sales venture and both companies are creating their own national field sales organizations, effectively disbanding Continental-Eastern Sales, Inc.". The article also reported that Mr. John Nelson, formerly Eastern's EVP of Marketing, would become Continental's EVP of marketing and would head the new sales organization. (Ex. 30).

57. Minimally, CESI was a poorly conceived and executed sales strategy for which Eastern and Texas Air management hold ultimate responsibility. Further, the sudden dissolution of CESI and Nelson's move from Eastern to Continental were not to Eastern's benefit, but were moves initiated by Eastern's management that insulated Continental from anticipated bankruptcy proceedings at Eastern.

Eastern agreed to pay a surcharge of 1 cent per gallon for fuel, to Texas Air, with no measurable benefit for the premium incurred. The agreement costs Eastern approximately $12 million per year; Eastern also incurs $6,000,000 in annual management fees to Texas Air with no apparent provision of service.

58. On April 1, 1987, Eastern Air Lines entered into a Fuel Service Agreement with newly created Texas Air Fuel Management, Inc. (TAC FMI). [EAL 10K Fuel Service Agreement, Exhibit 10.8, p. 1-8 (Ex. 31)]. TAC FMI is a wholly owned subsidiary of Texas Air. The agreement provided that Eastern purchase fuel-related services from TAC FMI with a surcharge of one cent per gallon which translates into approximately $10-12 million per year in fuel surcharge expenses, payable to Texas Air.

59. According to the DOT in their Report on the Financial Fitness of Eastern:

> a. The claimed rationale for Texas Air fuel was to combine Eastern's and Continental's purchases to wrest concessions from fuel suppliers. Yet Eastern's demand by itself - without supplementary Continental demand was sufficiently large that no increased buying power could be attributed by adding Continental. [DOT Fitness Report, Appendix 325, p.3 of [(Ex. 12)].
>
> b. the fuel management operation at Texas Air has potential to accumulate significant amounts for future "capital investment" while reducing overall cash flow of the segments. [DOT Fitness Report, DCAA Report, p. 2 of 8 [(Ex. 12)].

60. The agreement itself explicitly disclaimed any

guarantee to Eastern of any fuel savings, stating that: "...the Purchaser (Eastern) believes that the services provided by the Procurer (TAC FMI) may reasonably result in savings in the cost of Products of up to 5 percent...the Purchaser and the Procurer acknowledge that the aforementioned savings might not be readily and specifically quantifiable and, accordingly, the Purchaser is relying on its own assessment of the adequate performance of the Procurer..."[EAL 10K, December 31, 1987, Fuel Service Agreement, Exhibit 10.8 p. 2 (Ex. 31)].

61. Such a contractual provision raises a number of issues. Eastern entered into an agreement that would cost approximately $10-12 million per year without having a reasonable assurance that the arrangement would save at least $10-12 million. Not only did Eastern and Continental assume all of the costs and downside risks of establishing TAC FMI, they did so without receiving either guarantees or benefits or any equity position in the company. There is nothing that TAC FMI does for Eastern and Continental that could not be done without the intervention of TAC FMI at a cost of $.01 cent for every gallon consumed. In any event, if there were opportunities for improvement in fuel management at Eastern and Continental, these improvements could have been made at the airlines instead of turning the self described problem into a fee opportunity for Texas Air. The TAC FMI fee arrangement is separate and in addition to a $6 million per year management fee that Eastern

incurs from Texas Air with no readily apparent provision of services. In total, Eastern is incurring at least $16-18 million per year for questionable management assistance.

Eastern sold 11 Newark gates to Continental for a 10 percent, $11 million face value promissory note due in 1998.

62. In March of 1987, Eastern sold Continental eleven Newark gates for $11 million, and accepted a 10 per cent promissory note due on December 31, 1998, in consideration [EAL 10K, December 31, 1987, p. 48 (Ex. 16)]. In the third quarter of 1986, Eastern agreed to sell 8 Charlotte gates to Piedmont for $25 million in cash. [EAL 10K, December 31, 1986, p. 46 (Ex. 32)].

63. The DOT Report commented on the Newark gate transactions noting that:

> a. In March 1987, AVMARK (an airline consulting firm) appraised the Newark gates at $2.05 million each, and that AVMARK'S appraisal indicated that Eastern itself had placed a value of $1.875 million for each gate. [DOT Fitness Report, May 25, 1988, Appendix 330, p.1 of 2 (Ex. 12)].
>
> b. In our review of major intercompany asset transfers (Appendix 4) we noted that established values appear low for transactions related to ...gates at Newark. [DOT Fitness Report, DCAA Report, p. 4 (Ex. 12)].

64. Eastern's "independent management" apparently failed to establish a market price for the gates prior to their sale to Continental, accepted a note instead of cash, and

accepted a long term note from a substandard credit (risk) at below market rates and below Eastern's own borrowing rate.

> Eastern proposed selling its highly profitable Shuttle to Texas Air for far less than it was worth, and proposed accepting a $100 million note in partial payment. Eastern has recently executed a purchase agreement with Mr. Donald Trump for the Shuttle, depriving Eastern of its most profitable operating asset and one that is central to its core system.

65. The Eastern Shuttle is an important strategic asset. In addition to consistently contributing $40-$60 million in operating cash flow, the Eastern Shuttle is the core of Eastern's market presence and public awareness in important Northeast markets, including New York. [Shuttle Proceedings, Defendant's Exhibit 122, p. 2 (Ex. 33)] During 1988, Eastern maintained that its future as a carrier evolved around the important North-South, East Coast Corridor. The removal of the Eastern Shuttle as a highly recognizable "brand" will substantially diminish Eastern's visibility in those critical markets. Even with all of the pre-bankruptcy negative publicity concerning Eastern Air Lines and aggressive competition from Pan Am, the Eastern Shuttle commanded a 55%-60% share of the market at the time of the sale. The Eastern Shuttle is a high recognition brand name that has been developed over two decades.

66. Eastern has argued that the sale of the Eastern Shuttle is easily accomplished with minimal operational disruption. This may be true, but it in no way minimizes its

strategic significance to Eastern Air Lines. Ease of removal and strategic significance are not equivalent concepts.

67. In court testimony, Mr. Daniel Kasper, Eastern's expert witness, defined the "core routes" of an airline as those that an "airline would defend where it is either essential or most important to the airline or where it is strongest relative to the competition." Mr. Kasper went on to agree that "it [The Shuttle] is certainly one of the markets in which Eastern is strong relative to its competition" [Fall Downsizing Proceedings, August 19, 1988, Kasper Testimony, pp. 207-208 (Ex. 34)]. Eastern's own management, in the memo known as the "chunks" memo acknowledges that the sale of its Shuttle operations will reduce Eastern's "dominant position in the Northeast." See infra, ¶ 96, (Ex. 60).

68. Yet the Shuttle was the first asset that Eastern tried to spin off in 1988. In fact, Eastern's first attempt at spinning off the Shuttle was to a new Texas Air subsidiary for $225M, comprised of $125M in cash and a $100M note. [EAL 10K, December 31, 1987, p. 49 (Ex. 35)]. This transaction was abandoned following litigation challenging the transaction by the IAM. It is worth noting that the bid from Mr. Trump was significantly greater than the value Eastern would have received if the Texas Air transaction had been completed even after considering differences in the two transactions.

69. Eastern has also argued that the loss of the highly recognizable, brand name "Eastern Shuttle" will not cause a loss of traffic to the remainder of Eastern Air Lines because Trump Air will be tied into the "One Pass" frequent flyer program. However, this tie-in protects Texas Air and its subsidiary, Continental, and not necessarily Eastern Air Lines. Continental Airlines operates substantially more departures out of the "New York Metro" airports than Eastern. The frequent flyer program tie-in with Trump Air will cause passengers to think "One Pass", but not necessarily Eastern. As a result of Eastern's shrinkage in New York, and Continental's growth, this tie-in will more likely produce benefits for Continental rather than for Eastern.

70. Eastern has argued that interest earned on the net cash portion of the sale proceeds and interest saved on the debt retired will approximate $30 million, thereby exceeding the profit earned by the Eastern Shuttle. This assertion is misleading and inaccurate. The Eastern Shuttle's fully allocated profits have ranged from $15-20 million per annum after allocation of overhead expenses largely unrelated to operating the Eastern Shuttle. Unfortunately, a significant amount of these overhead expenses will remain after the sale of the Eastern Shuttle. As a result, Eastern will have $30 million to offset these overhead expenses from interest income and interest savings, rather than the $60-70 million projected by Eastern to be generated by the Eastern Shuttle. This results in a net

reduction of $30-40 million to Eastern Air Lines. Eastern will be operationally worse off by the $30-40 million reduction in operating cash flow (Ex. 35).

71. Eastern's decision to sell the Eastern Shuttle contradicts Eastern's and Texas Air's claim of their commitment to operate a profitable and viable Eastern. The sale of the Eastern Shuttle was ill conceived, and will accelerate the Company's downward spiral by removing Eastern's only consistently profitable operation and one of the key underpinnings of Eastern's presence in critical Northeast markets.

> On April 10, 1987, Eastern sold its Computer Reservation System (CRS) to a Texas Air subsidiary for a subordinated 25 year, 6 percent note with a $100 million face value; the PARS system, a comparable system currently owned by TWA and Northwest, was sold in the same time period for a full value of $280 million.

72. Eastern has the distinction of being the only known airline that has sold 100 percent ownership of its CRS, System One. The sale of Eastern's CRS and its back-office computer processing systems was both counter strategic and a stripping of significant value from Eastern.

73. Eastern accepted a $100 million, subordinated, 25-year note bearing a 6 percent rate of interest with a convertible feature of dubious value, from Texas Air, a company with a "speculative" credit standing; [EAL 10K, December 31, 1987, p. 10 (Ex. 36)]. System One, when it was owned by Eastern,

had a substantial and growing market share -- something that would not be true of a deteriorating system, as claimed by Eastern and Texas Air (Ex. 37). Indeed, since Texas Air acquired System One, its market share increased from 12 to 20 percent. (Ex. 57). Eastern recently estimated the current value of System One at $750 million, an acknowledgement of the inherent underlying value of the asset. (Ex. 57)

74. Eastern sold 100 percent ownership in a key strategic asset that was a "competitive weapon" and that could, conceivably, be used against Eastern if it were in the control of a competitor. Eastern sold the CRS without ostensibly obtaining guarantees that a controlling interest in the system would not, at a later date, be sold to a competitor.

75. In contrast to the $100 million note that Eastern received, PARS, a comparable system, was sold using a $280 million total valuation in the approximate time frame as System One was transferred to Texas Air. United sold 50% of the Apollo CRS System for $500 million, in May 1988, to 5 airlines. More recently, Delta combined its CRS' market share with that of the Sabre CRS System and purchased 50 percent of the system for $650 million. Delta and American now plan to sell shares in the combined system for a total of $2 Billion; [Northwest Airlines 10K, p. 1 (Ex. 38); PR Newswire re: Delta/American Agreement, February 5, 1989 (Ex. 39); Aviation Week and Space Technology,

"American, Delta Computer Reservations Deal May Intensify Global Competition," February 13, 1989, p. 6, Volume 130, No. 7, p. 94 (Ex. 40)].

76. Eastern accepted a deal that produced no cash when it was actively selling less strategic assets to generate cash. Eastern pays SystemOne, now a Texas Air subsidiary, to use the systems that it previously owned at costs in excess of Eastern's previous cost of operating the system directly. Further, Eastern no longer receives fees from third party subscribers for use of its computer systems; [EAL 10Q, March 31, 1987, pp. 12,14, (Ex. 41)] Eastern formerly paid a portion of the CRS's selling costs to travel agencies through Continental-Eastern Sales, Inc. (CESI) without receiving offsetting CRS revenues. Now that CESI has been disbanded, it is not clear which entity (SystemOne, Continental, or Eastern) will be responsible for SystemOne sales.

77. Eastern sold controlling interest in an asset that supposedly required major capital infusions and on which it relied for long term viability, to Texas Air, a company with limited sources of operating income which was in need of cash itself to support its highly leveraged capital structure. At a minimum, Eastern could have structured the transaction so that Eastern maintained at least part ownership of SystemOne -- much like TWA's and Northwest's joint ownership of PARS. Eastern might have received cash (which, according to management, Eastern needed and needs desperately) from an unrelated third party, and

could have maintained at least 50% interest in this strategic asset rather than losing 100% control. Currently, if Texas Air were to sell shares in SystemOne or merge it with, for example, Apollo, Eastern would receive no financial benefit from the transaction.

78. Eastern accepted a conversion price on a Texas Air note that was higher than the value that Frank Lorenzo apparently thought was a peak price -- as evidenced by his selling approximately 50 percent of his direct Texas Air holdings in a concurrent time frame as the SystemOne sale transpired [TAC 1987 Proxy, May 20, 1987, pp. 7-8 (Ex. 42)].

79. In the DOT Report, the Defense Contract Audit Agency (DCAA) states:

> a. In our review of major intercompany asset transfers we noted that established values appeared low for transactions related to (i) System I and .... [DOT Report, DCAA Report, p. 4, (Ex. 12)]
>
> b. The transfer of System I in April 1987 resulted in Texas Air issuing to Eastern a 6 percent, $100 million note, payable in total in the year 2012. The Note is not negotiable and is of little current value to Eastern. [DOT Report, DCAA Appendix 2B, p.4(Ex. 12)]

EASTERN'S FAILED STRATEGIES

80. In contrast to Texas Air's claims (*see*, *e.g.* Supplemental Affidavit of Phil Bakes under Local Bankruptcy Rule 52,), Eastern's labor costs are not the airline's most

significant problem. According to publicly available data, and Eastern's own testimony, Eastern's labor costs as a percentage of total costs are in line with those of its competitors. Based on a chart prepared by Aviation Daily that was introduced as evidence in Federal District Court, Eastern's labor expense as a percent of total cost is shown to be only fourth highest among major air carriers for 1987 (Aviation Daily, "Major and National Carriers' Labor Expenses," August 5, 1987 (Ex. 43).

81. A "Z" score is a widely recognized device among financial analysts for measuring a company's bankruptcy potential. A high "Z" score reflects a low bankruptcy potential; a low "Z" score suggests that bankruptcy is imminent. The Defense Contract Audit Agency used the "Z" score measure in the DOT's financial fitness review of Eastern. Eastern's "Z" score, shown in Exhibit 44, ["Eastern's Financial Fitness" (Ex. 44)] reflects a pattern that is repeated in much of Eastern's financial and operating data. In February 1986, two of Eastern's three unions granted significant wage concessions, resulting in four consecutive, profitable quarters. Subsequent to the wage concessions, Eastern's extremely low "Z" score began trending up and began, very rapidly, approaching the industry average. This turnaround at Eastern continued until the third quarter of 1987 -- the time-frame that Texas Air accelerated the asset stripping transactions at Eastern that began with the sale of Eastern's CRS in the second quarter of 1987.

82. If labor costs were the only issue, Continental would be a highly profitable airline because Continental's labor costs, according to the 1987 chart prepared by Aviation Daily, are the lowest among the major airlines, at 21.8% of total cost. (Exhibit 43). Despite the lowest labor costs among the major airlines, Continental has in fact lost more money in 1987 and 1988 than Eastern. The real problems at Eastern are:

a. The absence of any net investment to date by Texas Air in Eastern;

b. The stripping of cash and tangible assets from Eastern;

c. Its debt load, which markedly increased, as shown in Exhibit 45, under Texas Air's stewardship of Eastern ["Eastern's Long Term Debt" (Ex. 45)]; and

d. The downsizing of its system and the transfer of routes to Continental.

84. The downsizing of the system i.e., reduced flying and reduced capacity resulting from the elimination of routes, aircraft, gates, and other assets, has brought about the compromising of Eastern's operations in favor of Continental. In early 1986 Eastern's reduction in cost structure resulted in a significant drop in Eastern's cost per unit of flying as measured by cost per available seat mile (ASM). "Cost per ASM" is a standard industry measure of unit costs. This cost reduction was

achieved almost solely as a result of a voluntary reduction in pay, benefits and work rules by the pilots and flight attendants. Likewise, as Texas Air's downsizing strategy progressed, Eastern's operating results dramatically worsened. An examination of Eastern's quarterly financial information as filed with the SEC shows that Eastern's cost per available seat mile has been increasing dramatically. Unionized employees have had virtually no change in their wages and work rules during this period, and therefore should not be scapegoats for the cost per seat mile increases and resulting losses. During the third quarter of 1988, Eastern reported losses of approximately $112 million, despite stable labor costs, declining fuel prices and increased ticket yield (compared to the third quarter of 1987, the comparable seasonal period).

85. This loss is attributable to the increasing cost per seat mile which is the direct result of downsizing and lost passenger traffic. Exhibit 44 shows that Eastern's current ratios (current assets divided by current liabilites) and acid-test ratios (cash, marketable secruities, and accounts receivable divided by current liabilites) show improvement since Eastern's build up of cash in preparation for a strike. The dramatic worsening of Eastern's debt to equity ratio shows that Eastern's liquidity is being maintained through borrowings.

86. Just prior to the acquisition, Eastern was in such poor financial condition that Frank Borman, the CEO at the time

of the acquisition, stated that the airline needed to be "fixed, sold or tanked." The ratios in Exhibit 44 show that, far from improving the financial condition of Eastern, the Texas Air strategy has greatly worsened Eastern's financial condition.

87. As of the end of the 1988 third quarter, which does not reflect the impact of the September downsizing of the airline, Eastern's operating performance had continuously deteriorated since Texas Air took control of the air carrier:

a. ASM's declined 25% in 21 months ("Eastern's available seat miles, Eastern's Cost per ASM" (Ex. 46);

b. Costs per ASM have increased 31% in 21 months ["Eastern's cost per ASM" (Ex. 47) "Eastern's Available Seat Miles, Eastern's Cost per ASM" (Ex. 46)];

c. Eastern was exceeding its breakeven load factor of 59% by 1% prior to Texas Air's acquisition of Eastern; Eastern's most recent SEC filing shows a 9% gap between Eastern's breakeven and realized load factors ("Eastern's Passenger vs. Breakeven Load factors" (Ex. 48)]; and

d. Just prior to Texas Air's acquisition of Eastern, Eastern's total revenues per ASM marginally exceeded its total costs per ASM; Eastern's most recent SEC filing shows a 31%

increase in its cost per ASM. Furthermore, Eastern's costs per ASM now exceed its revenues per ASM by 16% ["Eastern's Total Revenues/ASM vs. Costs/ASM" (Ex. 49)].

88. The downsizing undertaken at Eastern has hurt Eastern's profitability, as measured by dramatic increases in Eastern's costs per ASM.

89. Regarding the prudence of downsizing to the extent undertaken by Eastern in the Fall of 1988, Mr. Kasper was asked whether he had "ever advised a major airline to reduce ... its operations of the magnitude represented by the fall schedule of Eastern." Mr. Kasper testified, "I have not." When asked "...have you ever known a major airline to reduce the level of its operations in the order of magnitude as represented by Eastern's fall schedule and thereby return to profitability," Mr. Kasper could only respond by naming airlines that have not survived as independent carriers but were merged into larger entities. Mr. Kasper's testimony is included in Exhibit 50 (Shuttle Proceedings, December 7, 1988, Kasper Testimony, p. 21 (Ex. 50)].

90. Since Eastern's operations were covering their variable costs of operation and contributing to fixed cost coverage, dropping operations, even assuming that associated aircraft are immediately sold, will reduce profitability. This is the case because an airline's fixed cost infrastructure of

ground facilities, overhead operations, and unsecured debt are a significant percentage of its costs and are not eliminated in an operational downsizing. This reduced profitablity has been demonstrated through the 3rd quarter of 1988, after the results of the Fall downsizing, as discussed in Mr. Kasper's December testimony, which is summarized below and included as Exhibit 51 [Shuttle Proceedings, December 7, 1988, Kasper Testimony, pp. 1022-1027 (Ex. 51)]:

> Question: Mr. Kasper, previously you came before this court to assert [that] by elimination of the Kansas City hub and the other steps associated with the fall schedule changes at Eastern, Eastern Air Lines would be in a position to reduce both its losses and its cash outflow....Isn't it true, Mr. Kasper, that just the opposite has happened and that in the aftermath of the fall schedule change the impact has been that the unit costs at Eastern Air Lines have increased?...
>
> Kasper: ...Unit costs are increased, yes....
>
> Question: The short answer is unit costs have increased; is that right?
>
> Kasper: Unit costs today are higher than unit costs the last time we were in his courtroom
>
> Question: it is also true that losses have increased: isn't that right?
>
> Kasper: Losses for the third quarter are higher than losses for the second quarter.
>
> Question: Losses have increased since the close of the third quarter, haven't they?
>
> Kasper: There are further losses in the first two months of the final quarter.
>
> Question: ...cash outflow has increased, has it not?
>
> Kasper: Cash outflow did increase in the third quarter, yes.

Question: It increased since the third quarter, did it not?

Kasper: Cash outflow, continue to have a negative cash outflow to date.

91. When considering major airlines, the converse of the airline downsizing axiom is that the greater the revenues of an airline, the greater its size, the greater its market dominance, the more profitable it is likely to be, the more dominant will be its price leadership, the lower are, in general, its unit costs, and the stronger it is likely to grow. In fact, it is these very same "critical mass" concepts that have driven Texas Air to grow, largely for the benefit of non-union Continental.

92. Texas Air senior management has expressed these very same concepts in previous proceedings:

> a. In our judgment the ingredients for success in this new [deregulated] environment include large fleets, strong routes with domestic and international coverage, marketing power, management strength and low cost operating economics. [Draft of Frank Lorenzo Speech in Japan on November 5, 1986 (Ex. 52)]
>
> b. Well, there is a vast difference in the profitability of a modestly expanding airline and an airline that either contracts or remains dormant or stagnant... [Douglas C. Birdsall, Continental Airlines, December 14, 1984, U.S. Bankruptcy Court Chapter 11 Proceedings (Ex. 53)]
>
> c. ...we've determined that it makes much less sense and subjects the creditors and the shareholders to much more risk to reduce the size of the airline ... [Mickey P. Foret,

Continental Airlines, December 28, 1984, U.S. Bankruptcy Court Chapter 11 Proceedings (Ex. 54)]

93. There is no doubt that Texas Air understands and believes in the critical mass concept. Not only have Texas Air's senior management been proponents of critical mass concepts, but their actions at Continental unequivocally demonstrate their strong adherence to them. Those actions have included:

a. Acquiring the remaining minority interest at New York Air;

b. Acquiring nearly bankrupt People Express (substantial operations in Newark);

c. Acquiring the assets of bankrupt Frontier Airlines (primarily in Denver);

d. Acquiring Eastern Air Lines;

e. Continental's acquisition of numerous commuter lines;

f. Texas Air merging its acquisitions (except Eastern) into Continental;

g. Increasing Continental's operating fleet;

h. Increasing Continental's route system; and

i. Wielding its market share into a price leadership position to generate cash flow.

94. Continental began its rapid growth while it was in Chapter 11. Texas Air management acquired these ailing airlines

because of its belief that the only way to be successful in the airline industry is to grow. Growth through the acquisition of assets at bargain prices, financed through extensive borrowing, is a hallmark of Texas Air. As Frank Lorenzo articulated in his November 5, 1986 Japan speech (Ex. 52), "Internally, we have restored Continental to financial health, expanded its fleet, and refined its route structure. Externally, we have made acquisitions that give us the critical mass necessary to compete nationwide and to significantly increase our marketing capabilities." Mr. Lorenzo goes on to say "...Eastern is an excellent franchise and we were able to buy it at a bargain price because of its high cost structure."

95. Texas Air management purchased seriously ailing airlines and merged them into Continental to fuel Continental's growth. Furthermore, Continental has not shrunk materially in size, despite record losses -- losses essentially equivalent to or greater than those incurred at Eastern. It is not possible to rationalize the investment made by Texas Air in Continental against the decisions made by Texas Air at Eastern.

96. There has been a substantial transfer of Eastern's flying to Continental since Texas Air's acquisition of Eastern. (Ex. 55). Those actions can be explained by recognizing that the shrinkage which Texas Air has induced at Eastern has largely benefited other parts of the Texas Air empire. Eastern's plan to dismantle and to downsize Eastern was

outlined in the "chunks" memo which is included as Exhibit 56 in this Declaration. [Fall Downsizing Proceedings, Plaintiff Exhibit 18 (Ex. 56)].

97. Frank Lorenzo and Texas Air understand that domestic routes represent intangible assets with real value, and that those assets can be cleverly transferred with barely a trace. For example, when Eastern has decided to drop a route with an origination or terminus at a Continental hub, no assets will have physically changed hands; no cash remuneration has been paid. However, such management decisions have caused Continental to grow and Eastern to correspondingly shrink, because Continental's market share and dominance have increased as Eastern's has declined. The One Pass System (Eastern's and Continental's Frequent Flyer Program) has been a primary vehicle of the route transfer strategy. When Eastern drops a route Continental stands to gain the majority of Eastern's market share because there is a consumer inclination to concentrate flying to take advantage of a frequent flier program.

98. A result of the route transfer strategy is that the net cost to Texas Air of Eastern's system shrinkage has been less than the substantial published losses at Eastern; further, these gains have reduced what otherwise would have been even more substantial losses at Texas Air and Continental. Texas Air understands that critical mass does not depend on whether the

planes are painted "gold and red" or "silver and blue". By transferring assets out of Eastern, Texas Air has largely:

a. Implemented a strategy for upstreaming cash from its financially ailing subsidiaries, cash that it cannot otherwise obtain through dividend payments because of lending contract restrictions;

b. Initiated its backup strategy of moving Eastern towards becoming an aircraft leasing company through downsizing transactions;

c. Achieved its goal of creating a nonunion merged airline with critical mass -- despite Eastern's union contracts and creditor/shareholder obligations; and

d. Protected itself from Eastern's creditors by maintaining distinctly separate corporate entities without providing guarantees on Eastern's obligations while removing vital Eastern assets.

CONCLUSION

99. Although many of the actions taken by Eastern management since Eastern was acquired by Texas Air were taken to increase liquidity, the Defense Contract Audit Agency

(DCAA), in the DOT Fitness Report, noted:

> ...the disposal of assets has not increased cash flow at Eastern as significantly as might have been expected because many transactions resulted in receipt of notes payable rather than infusion of specific capital resources. [DOT Fitness Report, DCAA Report Appendix, p.2, (Ex. 12)].

100. The many irrational and counter-strategic actions taken by Eastern's Directors and managers demonstrate that Eastern is, at a minimum, mismanaged. Indeed, Texas Air has been unable to realize a profit at either Eastern or Continental. Just prior to Texas Air's acquisition of Eastern, Eastern was earning a profit, largely in response to significant wage reductions accepted by Eastern's pilots and flight attendants. Since that time Eastern has not been profitable even though most of Eastern's employees have not received wage increases and the economic climate has been favorable to the major carriers. In fact, all but Pan Am and Texas Air are earning record profits in 1988. At Continental, despite labor costs that are far below those of the other major carriers, Texas Air has experienced major losses.

101. The losses that Texas Air has experienced are not so surprising when one realizes that the Texas Air empire is being managed without the benefit of long term financial and operational plans. The DOT Fitness Report observes that:

> a. ...the firms all have viable financial control mechanisms, and to varying degrees all have formal procedures for overall day-to-day planning and current year planning. The auditors observe , however

> that long-term planning is lacking throughout the Texas Air, Continental, and Eastern group." [DOT Report, p. 41, (Ex. 12)]
>
> b. Texas Air has apparently made no overall business plans for 1988, alleging that the situation at Eastern has been too volatile to make realistic projections possible .... Continental has prepared a series of plans for 1988. Eastern has not focused on specific financial plans other than immediate strike contingencies..... Eastern did prepare a plan for 1988 late in April, however, in response to our requests.... [DOT Report, p. 78 (Ex. 12)].

102. When the DOT Examination Team sought financial plans from Texas Air and its subsidiaries, Eastern's management explained that Eastern's volatility made planning impossible. However, it is in just such volatile environments that planning is critical.

103. In testimony in the the Shuttle procedings, Mr. Taylor, an Eastern Director, confirmed the DOT's finding. He testified that "it [Eastern] has a recovery concept. It does not have a recovery plan yet;" and when asked whether "Eastern had a business plan," Mr. Taylor responded, "no." [Shuttle Proceedings, Taylor Testimony, p.1526, (Ex. 4].

104. These irrational and counter-strategic actions taken by Eastern management are the result of incompetence, mismanagement, or a well thought out plan to strip Eastern of its assets. There is strong evidence that Texas Air directed a strategy for removing Eastern's component parts and transferring

them to Texas Air and Continental, leaving Eastern unable to function as an independent, viable air carrier. Allowing Eastern's management to remain as Debtor in Possession to manage Eastern's reorganization is entrusting the same individuals with responsibility to unwind the very same transactions that they previously formulated and implemented and which have subordinated and compromised Eastern's viability in favor of Continental's. Since no change in post-petition corporate structure is anticipated, there is no reason to believe that the conflict of interest that existed in the past will disappear in the future.

105. Texas Air management has extracted value from Eastern in such a way as to leave not only labor groups but Eastern's creditors "holding the bag." Texas Air has removed key component parts of Eastern that are important for Eastern's operational functioning and financial performance as a viable entity, while leaving behind enormous debts. Texas Air has done this in a manner designed to insulate Texas Air from the negative financial developments at Eastern.

106. Texas Air manufactured a financial crisis at Eastern by stripping assets from and transferring them out of Eastern, by incurring high fees for contracts and services with Texas Air, by downsizing, and by spending massive amounts for strike preparation. In 1987 alone, the net result of these actions on Eastern's financial statements was a $181.7

million loss rather than a break-even result. Texas Air is dismantling Eastern -- leaving a shell with enormous debts.

107. It is clear that the removal of key component parts such as the Shuttle and computer reservation system from Eastern was the first phase in its strategy. These initial steps were followed by a labor confrontation, to be utilized to create a low cost (non-union) Continental clone or justify a liquidation.

108. Texas Air's acquisition of Eastern does not represent a substantial investment for Texas Air. Most of the purchase price paid for Eastern's acquisition was paid by Eastern. Texas Air has since extracted the parts of Eastern that Texas Air needs to enhance itself and Continental, regardless of what happens to Eastern. So Texas Air's actual investment has already been recovered by the value of parts already extracted.

109. Regardless of whether Eastern or Continental flies Eastern's routes, Texas Air will realize the revenue from flying those routes; regardless of whether Eastern or SystemOne owns Eastern's CRS, Texas Air will realize the benefits. It simply doesn't matter what colors the planes are painted. Texas Air is no worse off. In fact, Texas Air benefits to the extent that it can shed any of Eastern's cost, debt and labor contract infrastructure while keeping Eastern's revenue generating assets, whether or not they are operated by Eastern. Continental's generation of huge losses is not a rebuttal of this analysis.

Rather, it demonstrates that Texas Air's management has mismanaged its low cost advantage over other major carriers. Thus, the problems at Eastern which have been disguised as labor cost are actually a result of a compromise of fiduciary responsibility, mismanagement, and incompetence.

110. Texas Air has already extracted many of the best parts of Eastern for the benefit of itself and its other subsidiaries and to the detriment of Eastern's creditors and labor groups, such as the System One (CRS) asset. Texas Air will achieve its ultimate goal, regardless of the adverse impact on Eastern's creditors, bondholders, preferred stockholders and employees, unless this Court appoints an independent trustee that will safeguard their interests.

I declare under penalty of perjury that the foregoing statements are true and correct.

Dated: March 13 , 1989

Farrell P. Kupersmith

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In Re:

EASTERN AIR LINES, INC.

Debtor

Chapter 11 Case No.
89 B 10449 (BRL)

EXHIBITS TO DECLARATION OF
FARRELL P. KUPERSMITH

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Excerpt from Eastern's 10K Form, December 31, 1987 . . . . Exhibit 18

Excerpt from Eastern's 10K Form, December 31, 1987 . . . . Exhibit 19

Excerpt from Federal District Court Judge Parker's Memorandum Opinion in the Fall Downsizing Proceedings, August 30, 1988 . . . . Exhibit 20

"Aircraft Lease Option," Plaintiffs' Exhibit 11 in the Shuttle Proceedings, December 31, 1988 . . . . Exhibit 21

Excerpt from Eastern's 10K Form, December 31, 1987 . . . . Exhibit 22

Excerpt from Eastern's 10Q Form, March 31, 1988 . . . . Exhibit 23

Excerpt from the testimony of Mr. Taylor in the Shuttle Proceedings, December 9, 1988 . . . . Exhibit 24

Excerpt from the Eastern/Texas Air Proxy Statement - Prospectus, October 15, 1986 . . . . Exhibit 25

Excerpt from Texas Air's 10Q Form, September 30, 1988 . . . . Exhibit 26

Excerpt from Eastern's 10Q Form, September 30, 1988 . . . . Exhibit 27

Excerpt from Eastern's 10Q Form, March 31, 1988 . . . . Exhibit 28

Excerpt from Eastern's *Falcon*, Volume 26, Number 5, June 24, 1987 . . . . Exhibit 29

Excerpt from *Aviation Daily*, December 12, 1988 . . . . Exhibit 30

"Fuel Service Agreement," Exhibit 10.8 to Eastern's 10K Form, December 31, 1987 . . . . Exhibit 31

Excerpt from Eastern's 10K Form, December 31, 1986 . . . . Exhibit 32

Offering Brochure for Shuttle, Defendant's Exhibit 122 in the Shuttle Proceedings . . . . Exhibit 33

Excerpt from the testimony of Mr. Kasper in the Fall Downsizing Proceedings, August 19, 1988 . . . . Exhibit 34

Excerpt from Eastern's 10K Form, December 31, 1987 . . . . Exhibit 35

Excerpt from Eastern's 10K Form December 31, 1987 . . . . Exhibit 36

Computer Reservation System Market Share Statistics from the Department of Justice and the Department of Transportation, August 30, 1988 . . . . Exhibit 37

Northwest Airlines' 10K Form for 1986 . . . . Exhibit 38

Newswire Press Release, "Delta Airline and American Airlines Agreement," February 6, 1989 . . . . Exhibit 39

Aviation Week and Space Technology, "American, Delta Computer Reservations Deal May Intensify Global Competition," February 13, 1989 . . . . Exhibit 40

Excerpt from Eastern's 10Q Form, March 31, 1987 . . . . Exhibit 41

Excerpt from Texas Air's 1987 Proxy Statement, May 20, 1987 . . . . Exhibit 42

Aviation Daily, "Major and National Carriers Labor Expenses," August 5, 1988 . . . . Exhibit 43

"Eastern's Financial Fitness," prepared by Touche Ross & Co. for submission to the Department of Transportation in support of petition for a fitness examination of Eastern, December 1988 . . . . Exhibit 44

"Eastern's Long Term Debt," prepared by Touche Ross & Co. for submission to the Department of Transportation in support of petition for a fitness examination of Eastern, December 1988 . . . . Exhibit 45

"Eastern's Available Seat Miles; Eastern's Cost Per ASM," prepared by Touche Ross & Co. for submission to the Department of Transportation in support of petition for a fitness examination of Eastern, December 1988 . . . . Exhibit 46

"Eastern's Cost Per ASM," prepared by Touche Ross & Co. for submission to the Department of Transportation in support of petition for a fitness examination of Eastern, December 1988 . . . . Exhibit 47

"Eastern's Passenger vs. Breakeven Load Factors," prepared by Touche Ross & Co. for submission to the Department of Transportation in support of petition for a fitness examination of Eastern, December 1988 . . . . Exhibit 48

"Eastern's Total Revenues/ASM vs. Costs/ASM," prepared by Touche Ross & Co. for submission to the Department of Transportation in support of petition for a fitness examination of Eastern, December 1988 . . . . Exhibit 49

Excerpt from the testimony of Mr. Kasper in the Shuttle Proceedings, December 7, 1988 . . . . Exhibit 50

Excerpt from the testimony of Mr. Kasper in the Shuttle Proceedings, December 7, 1988 . . . . Exhibit 51

Frank Lorenzo Draft Japan Speech, November 5, 1986, Plaintiffs' Exhibit 30 in the Fall Downsizing Proceedings . . . . Exhibit 52

Excerpt from the testimony of Douglas C. Birdsall in the Continental Chapter 11 Bankruptcy Proceedings, U.S. Bankruptcy Court for the Southern District of Texas, December 14, 1984 . . . . Exhibit 53

Excerpt from the deposition of Mickey P. Foret in the Continental Chapter 11 Bankruptcy Proceedings, U.S. Bankruptcy Court for the Southern District of Texas, December 28, 1984 . . . . Exhibit 54

"Trend in ASM at Eastern and Continental from January 1985 to July 1988," prepared by Touche Ross & Co., March 1989 . . . . Exhibit 55

CHUNKS Memo, Plaintiffs' Exhibit 18 in the Fall Downsizing Proceedings . . . . Exhibit 56

Excerpt from the testimony of Mr. Bakes in the Fall Downsizing proceedings, August 17, 1988 . . . . Exhibit 57

Mailgram from Eastern to Eastern pilots, March 2, 1989 . . . . Exhibit 58

Analytical Synopsis Regarding Texas Air and Airline Subsidiaries, prepared by Touche Ross & Co. for submission to the Department of Transportation, dated April 26, 1988 . . . . Exhibit 59

The above listed exhibits submitted by Mr. Kupersmith can be viewed in the Senate Subcommittee on Antitrust, Monopolies and Business Rights, 308 Hart Senate Office Building

AIR LINE PILOTS ASSOCIATION
1625 MASSACHUSETTS AVENUE, N.W. □ WASHINGTON, D.C. 20036 □ (703) 689-2270

March 27, 1989

Honorable Joseph R. Biden
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

During the Committee's hearing on S.544 on March 17th, you requested information for the record on transactions between airlines and their holding companies similar to that which is available for Eastern, People Express, Continental and Texas Air. The following is my response to your request.

"The amount of information on transactions between airlines and their holding companies varies depending on the corporate status of the subsidiaries. The primary factor which determines how much information about intercompany transactions is made public is whether the subsidiaries have either debt or equity in their name being traded on the open market. For example, although 100% of its common stock is owned by Texas Air, Eastern has six debt and four preferred stock instruments being publicly traded. Because it has such instruments, Eastern is required to file financial statements with the SEC. It is in these financial statements where Eastern identifies 'significant' intercompany transactions. These transactions are required to be acknowledged because they can have a material effect on the value of their financial instruments. Note that the selection of transactions to be included in SEC reports is based on the auditor's interpretation of what is significant.

"Of the twelve Major airlines, five file SEC reports separate from their parent corporations: Continental, Eastern, Flying Tigers, Pan Am and TWA. The remaining airlines' financial statements are presented strictly on a consolidated basis with their parent corporation: American, Delta, Federal Express, Northwest, Piedmont, United and USAir.

"Based upon our review of SEC filings for those five airlines which file separately, only Continental, Eastern and TWA have been involved in a significant number of intercompany transactions. Regarding the transactions between TWA and Icahn, I am submitting herewith for the Committee's review copies of the Emergency Petition to Institute a Continuing Fitness Investigation into Carl Icahn's management of Trans World Airlines filed with DOT by the Independent Federation of Flight

Attendants on August 30, 1988, and ALPA's Complaint for Injunctive and Other Equitable Relief filed with the Supreme Court of the State of New York, County of New York on September 7, 1988, which discuss the impact of these transactions."

I am also submitting additional material which you requested concerning the corporate structures of several of the major air carrier holding companies.

I hope this information and material is responsive to your request and will be helpful to the Committee in its deliberations on S. 544.

Sincerely,

Henry A. Duffy

Henry A. Duffy, President

HAD:sk

UAL CORPORATION

Subsidiaries

United Airlines (100%)
  - United Airlines Flight Center
  - United Airlines Services Corp.
  - United Aviation Fuels
  - United Airlines Credit Corporation

Covia Corporation (50%)

United Aircrew Training

UAL Leasing

Mileage Plus, Inc. (MPI)

United Vacations

Sources: 1987 Annual Report
Dow Jones Company Profile
Directory of Corporate Affiliations - 1989
Who Owns Whom - North America, Dun & Bradstreet 1988
America's Corporate Families, Dunn's Marketing Services, 1988

NOTE: Some of the above listings were compiled from publicly available information provided by the Company and thus, may not present the complete corporate structure.

TEXAS AIR CORPORATION

Subsidiaries

- **Continental Airlines** (100%)
  - Cargo Development Group, Inc.
  - People Express, Inc.
    - People Express Airlines, Inc.
    - Britt Airways, Inc.
  - Frontier Holdings, Inc.
    - Frontier Airlines, Inc.
  - New York Airlines, Inc.
  - Rocky Mountain Aviation, Inc.
    - Rocky Mountain Airlines, Inc.
  - Pro, Inc.
  - Continental-Eastern Sales, Inc. (50%)
  - Continental Express
    - Bar Harbour Airlines (50%)
  - Air Micronesia, Inc.
  - Continental Hotels, Inc.
    - Continental Agana Hotel Corp.
    - Continental Kalakaua Hotel Corp.
    - Continental Palau Hotel Corp.
    - Continental Saipan Hotel Corp.
  - Continental Mexico Corp.
  - Continental Tours Inc.
  - Continental Truk Hotel Corp.
  - Continental Venezuela Corp.
  - One Continental Plaza, Inc.
  - United Micronesia Development Association
  - Continental West Airlines, Inc.
  - Texas International Airlines, Inc.
    - Rubicon Indemnity Ltd.
    - TXIA Holdings Corp.
    - Texas International Airlines Capital N.V.
    - Texas International Airlines Finance B.V.
    - Texas International Airlines Finance N.V.
    - Texas International Airlines Overseas N.V.
    - Texas International de Mexico S.A. de C.V.

- **Eastern Air Lines, Inc.** (100%)
  - Ionosphere Clubs, Inc.
  - Continental-Eastern Sales, Inc. (50%)
  - Dorado Beach Development, Inc.
  - Dorado Beach Estates, Inc.
  - EAL, Inc.
  - EAL Properties, Inc.

TEXAS AIR CORPORATION

- Eastern Airlines of Puerto Rico, Inc.
- Eastern Trading Corporation
- Protective Services Corporation
- Terminal Sales Company
- Airport Ground Services Corp.
- Eastern Airlines Leasing, Inc.

SystemOne Holdings, Inc. (100%)
- EAL Automation Systems, Inc.
- System One Direct Access, Inc.
- CCS Automation Systems, Inc.
- Travel Resources, Inc.

Texas Air Leasing Corp. (100%)

TAC Fuel Management, Inc. (100%)

CVR Holdings, Inc.

FHI Acquisition, Inc.

SWF Acquisition, Inc.

TAC 301 Corp.

TAC 302 Corp.

TAC 303 Corp.

TAC 304 Corp.

TAC 306 Corp.

TAC 307 Corp.

TAC 309 Corp.

TAC 312 Corp.

TAC 313 Corp.

TAC.311 Corp.

TEXAS AIR CORPORATION

Sources:
1987 Annual Report
SEC Form 10-K for year ending 12/31/87
Prospectus dated February, 1987
Dow Jones Company Profile
Directory of Corporate Affiliations - 1989
Eastern Airlines' Voluntary Petition for Relief Under Chapter 11, Title 11, United States Code
Who Owns Whom - North America, Dun & Bradstreet 1988
America's Corporate Families, Dunn's Marketing Services, 1988

NOTE: Some of the above listings were compiled from publicly available information provided by the Company and thus, may not present the complete corporate structure.

AMR CORPORATION

Subsidiaries

AMR Capital Corp.

AMR Information Services
(Data Handling, Information Processing & Communications)
- AMR Caribbean Data Services (Data Entry Center in the Dominican Republic)
- American Airlines Direct Marketing Corporation (100%) (Telemarketing & Catalogue Sales, Publishes "American Traveler" Magazine)
- AMR Travel Services (Automated Reservation Services for Hotels & Car Rental Firms)
- AMR Freight Automation
- AMR Airline Automation Systems (Provides Passenger Processing & Airline Automation Systems to other Airlines)
- AMR Technical Training (Training in Transaction Processing & Telecommunications Technologies)

AMR Services Corporation
(Aircraft Loading & Unloading, Baggage Handling, Cabin Cleaning, Freight Warehouse & Skycap Services)
- Northern Air Services, Inc.

American Airlines Direct Marketing Corp.

American Airlines, Inc. (100%)
- American Airlines Fuel Corporation
- American Airlines Overseas Finance, N.V.
- American Airlines Ventures I, Inc.
- American Airlines Credit Corp.
- Admirals Club, Inc.
- Air Data Center, Inc.
- Air Cal, Inc.
    - Air California
- American Airlines of Italy, Inc.
- American Airlines de Mexico S.A. de C.V.
- American Airlines de Venezuela S.A.
- American Inter-island, Inc.

AMR CORPORATION

- New American Credit Corporation
- Avenue H Properties, Inc.
- D/FW Terminal Corp.

AMR Investment Services, Inc.
(Provides Investment Management Services to Institutional Investors)
- Memphis Aero Corporation
- Jetco, Inc.

AMR Leasing Corporation
(Aircraft Leasing to other carriers)

AMR Eagle, Inc.
- Nashville Eagle, Inc.

AMR Foundation

AMR Properties, Inc.

Source: AMR Corp. 1987 Annual Report
Company 1987 10K SEC filing
Directory of Corporate Affiliations-1989
Dow Jones Company Profile
Who Owns Whom - North America, Dun & Bradstreet 1988
America's Corporate Families, Dunn's Marketing Services, 1988

NOTE: Some of the above listings were compiled from publicly available information provided by the Company and thus, may not present the complete corporate structure.

NWA, INC.

Subsidiaries

- **Cardinal Insurance Company** (100%) (Minneapolis-St.Paul Airport)
- **Northwest Airlines, Inc.** (100%)
- **MLT Vacations, Inc.** (100%)
- **Northwest Aerospace Training Corporation** (NATCO) (100%)
- **Northwest Aircraft, Inc.** (100%) (Aircraft Lessor)
- **Northwest Computer Services, Inc.** (100%)
  (Holding Company for Airline Reservation System)
- **Northwest PARS, Inc.** (100%)
  (Holding Company for Airline Reservation System - Marketing)
  - PARS (50% ownership with TWA)

Source:
NWA, Inc. 1987 Annual Report
Company 1987 10K SEC filing
Directory of Corporate Affiliations-1989
Dow Jones Company Profile
Who Owns Whom - North America, Dun & Bradstreet 1988
America's Corporate Families, Dunn's Marketing Services, 1988

NOTE: Some of the above listings were compiled from publicly available information provided by the Company and thus, may not present the complete corporate structure.

PAN AM CORPORATION

Subsidiaries

Pan American World Airways, Inc. (100%)
- ALLMAT International, Inc.
- Aeronatutical Radio Ltd.
- Agropecuaria Fluminence S.A.
- Air Cargo, Inc.
- Airline Tariff Publishing Co.
- Delsud Inversora s.r.l.
- Escola Americana de Rio de Janeiro
- Honolulu Fueling Facilities Corp.
- International Aeradio (Caribbean) Ltd.
- Liberian Development Corp.
- Manhattan Air Terminal Inc.
- Middle East Real Estate Co. S.A.L.
- Nigerian Aviation Handling Co.
- Pan Am Asset Management, Inc.
- Pan Am Energy, Inc.
- Pan Am Thriftway Ltd.
- Pan American Airways de Mexico S.A.
- Pan American World Airways South Africa Pty. Ltd.
- Promotora de Hoteles de Turismo Medellin S.A.
- Social Immobiliaria Norteamericana S.A.
- Societe International de Telecommunications Aeronautiques S.A.

Pan Am Express, Inc. (100%)

Pan Am Shuttle, Inc. (100%)

Pan Am World Services, Inc. (100%)
- TGS Technology, Inc.
  (Formerly Technicolor Government Services, Inc., Provides Technical Support Services under Contract to US Government Agencies)
- Alert Management Systems, Inc.
  (Contract Security and Protective Force Services, predominantly for aviation customers)
- Pan Am Support Services, Inc.
  (Rotary & Fixed-wing Flight Training Services)

PAN AM CORPORATION

Pan Am Commercial Services, Inc. (100%)

Pan Am Financial Services, Inc.

Pan Am Technological Services, Inc.

Hadrian, LTD.

Pan Am Environmental Systems, Inc.

Source:
Pan Am Corp 1987 Annual Report
Company 1987 10K SEC filing
Directory of Corporate Affiliations-1989
Dow Jones Company Profile
Who Owns Whom - North America, Dun & Bradstreet 1988
America's Corporate Families, Dunn's Marketing Services, 1988

NOTE: Some of the above listings were compiled from publicly available information provided by the Company and thus, may not present the complete corporate structure.

USAIR GROUP, INC.

Subsidiaries

Piedmont Aviation, Inc. (100%)

- Piedmont General Aviation Group (Gen. Aviation Sales & Services)

    - Air Services, Inc. (100%) (General Aviation)
    - Asheville Flying Service (100%)
    - Aviation Supply Corporation

- Piedmont Airlines, Inc. (100%)

Henson Aviation, Inc.
- Henson Airlines (100%)

Jetstream International Airlines, Inc.

Pennsylvania Airlines, Inc. (100%)

Suburban Airlines, Inc. (100%)

USAir, Inc. (100%)
- Pacific Southwest Airmotive (100%) (Jet Engine Overhaul & Repair)

USAir Leasing & Services, Inc. (100%)

USAir Fuel Corporation (100%)

Clark Leasing Corporation

Pacific Southewst Airlines, Inc. (100%)

USAir Finance N.V.

USAIR GROUP, INC.

Source: USAIR 1987 Annual Report
Company 1987 10K SEC filing
Directory of Corporate Affiliations-1989
Dow Jones Company Profile
Who Owns Whom - North America, Dun & Bradstreet 1988
America's Corporate Families, Dunn's Marketing Services, 1988

NOTE: Some of the above listings were compiled from publicly available information provided by the Company and thus, may not present the complete corporate structure.

DELTA AIR LINES, INC.

Subsidiaries

- **Epsilon Trading, Inc.**
- **Deltair U.K. Investments Limited**
- **DeltaSub, Inc.**
- **WAL Communications, Inc.**
- **Travel Air Music, Inc.**
- **Atlantic Southeast** (20%)
- **Comair** (20%)
- **Sky West** (20%)

Sources: 1987 Annual Report

NOTE: Some of the above listings were compiled from publicly available information provided by the Company and thus, may not present the complete corporate structure.

CARL ICAHN - TWA

Proposed in Privatization Plan:

1) CARL ICAHN

2) ICAHN HOLDING CORPORATION

3) ICAHN CAPITAL CO

4) HERON INVESTORS CORP

5) ACF INDUSTRIES, INCORPORATED

6) AERO LIMITED PARTNERSHIP, EXCALIBUR PARTNERS, MANDRAKE PARTNERS LIMITED PARTNERSHIP

7) HOLDING

8) TWA

ACF Subsidiaries (1)

- ACF Canada (1985) Ltd.
- ACF Industries, Inc.
- ACF International Sales Corporation
- ACF Petroleum Co. Inc.
- ACF Leasing Co.
- ACF Sales Corp.
- AERO Limited Partnership
- Amcar Investment Plan Inc.
- Carweb Inc.
- Composite Car Inc.
- Excalibur Partners
- Ferris Wheel Associates Ltd. Partnership
- GNU Corp.
- Hare Investors Plan Inc. (wholly owned)
- Harmonious Assoc. Ltd. Partnership
- Health Investors Ltd. Partnership
- Mandrake Ltd. Partnership
- O'Riole Corp. Inc.

CARL ICAHN - TWA

- SHPX Fifth Corporation
- Shippers Car Line Investment Plan Inc.
- Stork Associates Ltd. Partnership
- Turtle Investors Corp.
- Unicorn Associates Corp.

TWA Subsidiaries (1)

- Airport Terminal Services, Inc.
- Ambassador Fuel Corporation
- Blue Jay Investment Plan, Inc.
- Cricket Holdings
- Elsinore, Inc.
- Elytron, Inc.
- International Aviation Security, Inc.
- Midcoast Aviation, Inc.
- Midcoast Little Rock, Inc.
- The Getaway Group, Inc.
- The Getaway Group, (U.K.) Inc.
- Northwest 112th Street Corporation
- Ozark Holdings, Inc.
- Storm Haven, Inc.
- Swan Management Corporation
- Transcontinental & Western Air, Inc.
- Trans World Airlines (Australia) Pty. Ltd.
- Trans World Compurter Services, Inc.
- Trans World Pars, Inc.
- The Travel Channel Inc.
- TWA Ambassor Club, Inc.
- TWA Associates, Inc.
- TWA De Mexico, S.A. De C.V.
- TWA Group, Inc.
- TWA Investment Plan, Inc. (wholly owned)
- TWA Marketing Services Inc.
- TWA Serivices
- TWA Subsidiary, Inc.
- TWA Standards & Controls

CARL ICAHN - TWA

Additional Icahn-related Companies Appearing in Source Material:(1)

- **AMBASSADOR BOUTIQUE**
- **AMBASSADOR CAPITAL CORP.**
- **BANQUE COMMERCIALE PRIVEE**
- **BAYSWATER ACQUISITION CORP.**
- **BAYSWATER REALTY AND CAPITAL CORP. (DE)**
- **BAYSWATER REALTY BROKERAGE**
- **BUFFALO INVESTORS CORP (NY)**
- **CARL C. ICAHN FOUNDATION**
- **CONDOR INVESTOR ASSOCIATES (CT)**
- **CRANE ASSOCIATES (NY)**
- **GNU (NY)**
- **HOME STATE FINANCIAL SERVICES (OHIO)**
- **HERON INVESTORS PLAN (DE)**
- **IAC-ICAHN ACQUISITION CO.** (owned by Carl Icahn)
- **ICAHN & CO. INC. (NY)** (owned by Icahn Capital Corp.)
- **ICAHN GROUP INC.**
- **ICAHN INSTITUTIONAL SERVICES**
- **ICAHN OPTION MANAGEMENT (NY)**
- **ICAHN SECURITY TRADING COMPANY INC (NY)**

CARL ICAHN - TWA

- **LONGVIEW INVESTORS LIMITED PARTNERSHIP (CT)**
- **MICHELLE INVESTORS CORP.**
- **MOUSSARO COMMERCIA, SA**
- **PRIM ROSE ASSETS, INC.**
- **OCELOT ASSOC. CORP.**
- **OCELOT INC.**
- **RIVERDATE INVESTORS CORP. (DE)**
- **RIVERDALE INVESTORS PLAN**
- **SHILOH INVESTORS CORP.**
- **JEFFREY STEINER (NV)**
- **TWA ACQUISITION PARTNERSHIP** (86% held by TWA Holding Partnership) (2)
- **TWA HOLDING PARTNERSHIP**
- **UNICORN ASSOCIATES (NY)**
- **USX ACQUISITION PARTNERSHIP**
- **VIACOM ACQUISITION PARTNERSHIP**
- **VIACOM HOLDING PARTNERSHIP**
- **W. INVESTMENT CO.**

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1) Except as noted, extent of corporate ownership is not reflected in source documents.

2) Disposition of these entities is unclear.

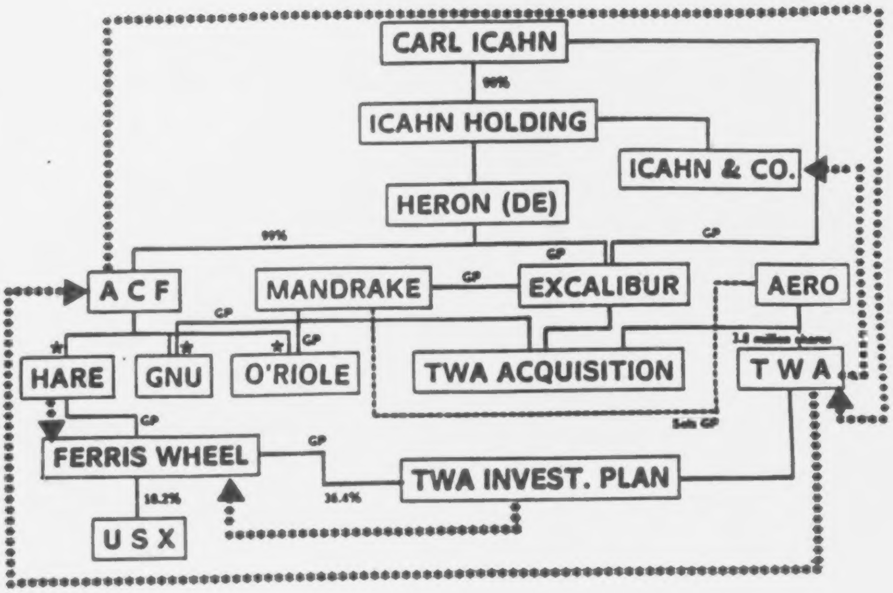
CARL ICAHN - TWA

SOURCE: Emergency Petition of Independent Federation of Flight Attendants to Institute a Continuing Fitness Investigation (Docket 45792)
(See Enclosed Exhibits)
TWA SEC Schedule 13E-3, August 12, 1988

NOTE: Some of the above listings were compiled from publicly available information provided by the Company and thus, may not present the complete corporate structure.

A PORTION OF THE ICAHN EMPIRE

FLOW OF FUNDS AND COMPANY RELATIONSHIPS
(TWA S-4 8/12/88)


CARL ICAHN
99%
ICAHN HOLDING
ICAHN & CO.
HERON (DE)
99%
GP
GP
A C F
MANDRAKE
GP
EXCALIBUR
AERO
GP
GP
HARE
GNU
O'RIOLE
TWA ACQUISITION
1.8 million shares
T W A
Sole GP
GP
FERRIS WHEEL
GP
TWA INVEST. PLAN
18.2%
36.4%
U S X

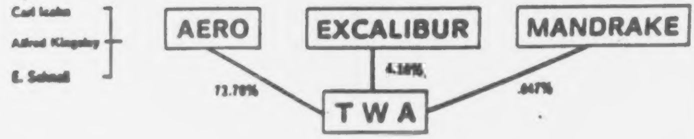
GP = General Partner

★ 100% owned

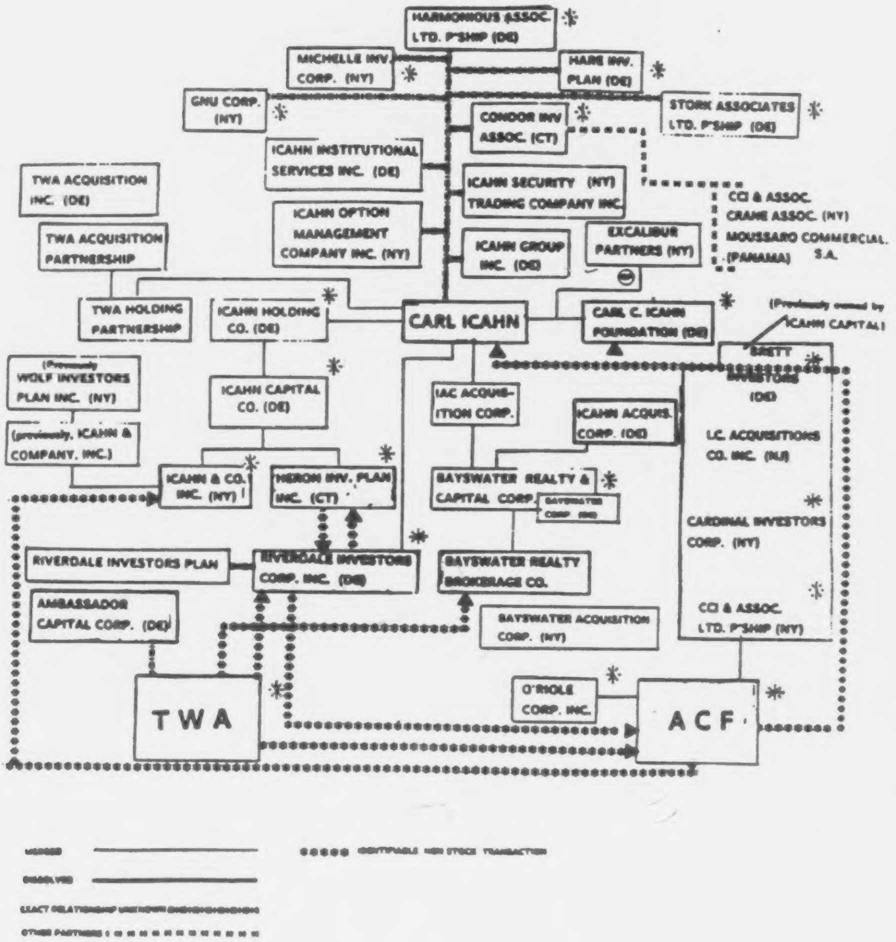
●●●●●●● IDENTIFIABLE NEW STOCK TRANSACTION

Beneficial Ownership

CARL ICAHN 76.84%

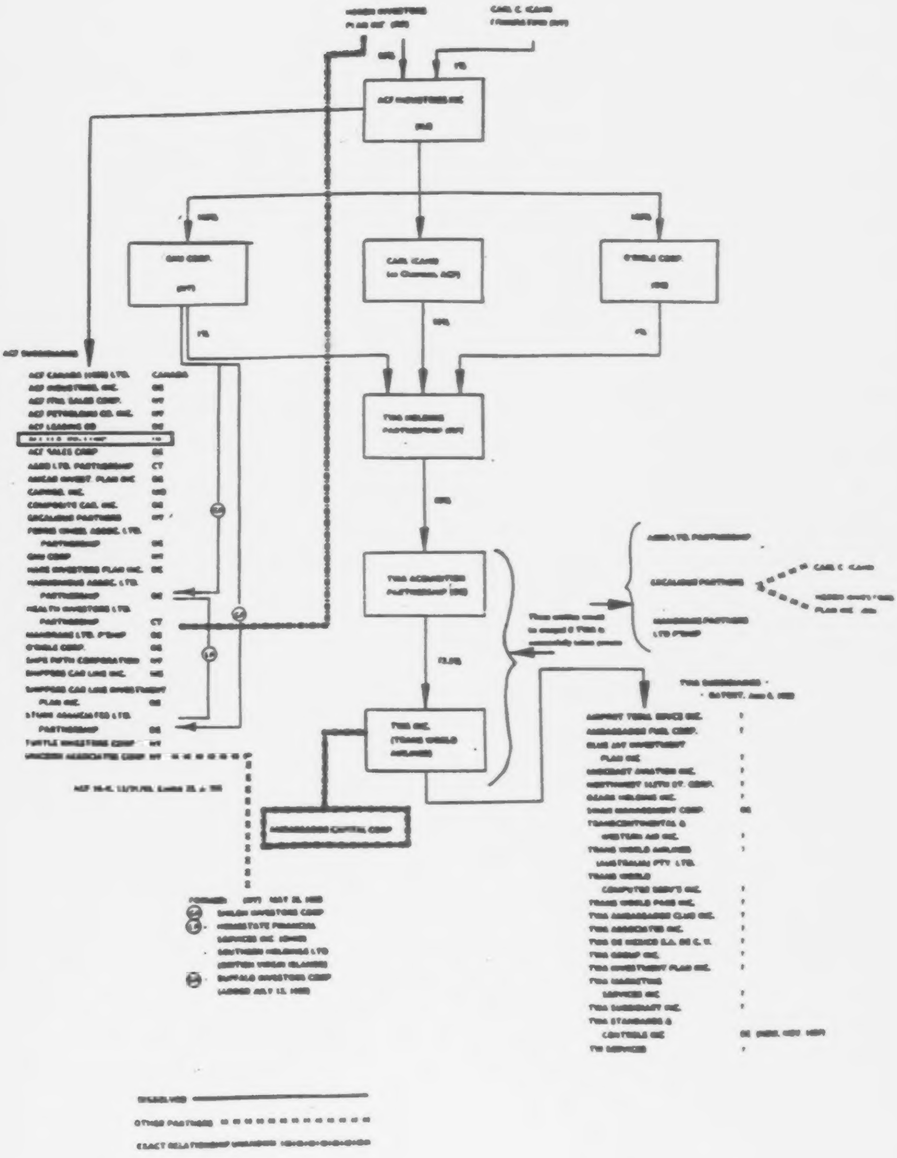

Carl Icahn
Alfred Kingsley
E. Schnall
AERO
EXCALIBUR
MANDRAKE
73.70%
4.10%
.047%
T W A

FLOW OF FUNDS FROM
TWA AND ACF
AND WHERE CARL ICAHN SIGNS *

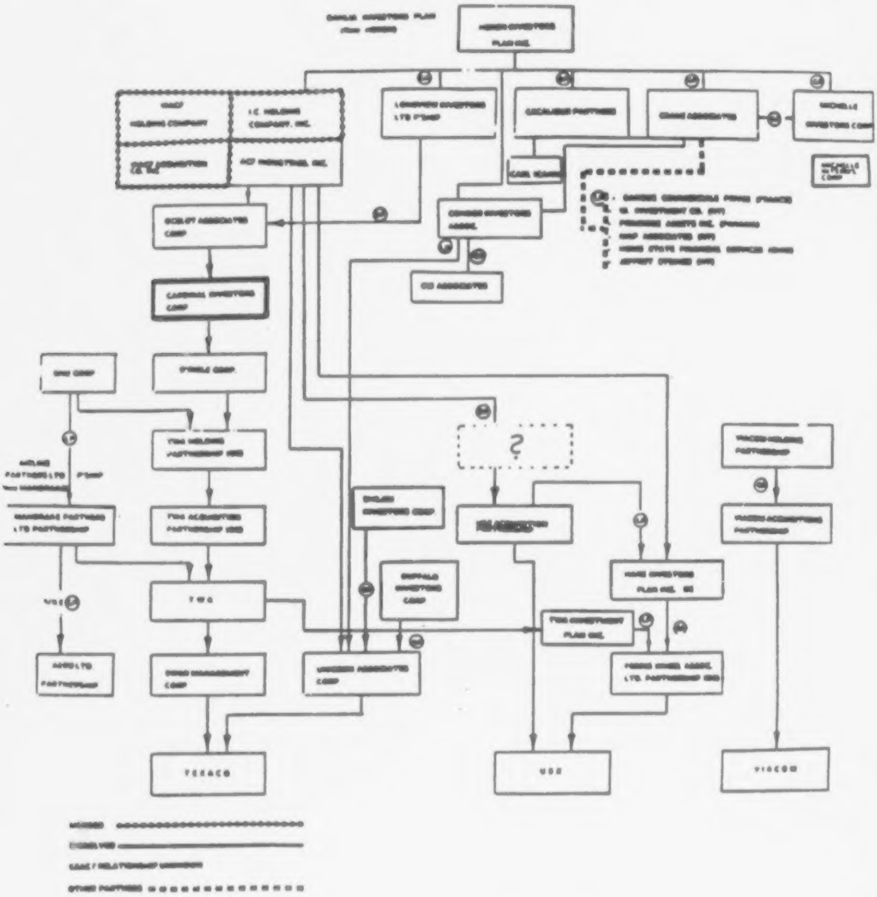

HARMONIOUS ASSOC. LTD. P'SHIP (DE)
MICHELLE INV. CORP. (NY)
HARE INV. PLAN (DE)
GNU CORP. (NY)
STORK ASSOCIATES LTD. P'SHIP (DE)
CONDOR INV ASSOC. (CT)
ICAHN INSTITUTIONAL SERVICES INC. (DE)
TWA ACQUISITION INC. (DE)
ICAHN SECURITY (NY) TRADING COMPANY INC.
CCI & ASSOC.
CRANE ASSOC. (NY)
MOUSSARO COMMERCIAL S.A. (PANAMA)
TWA ACQUISITION PARTNERSHIP
ICAHN OPTION MANAGEMENT COMPANY INC. (NY)
ICAHN GROUP INC. (DE)
EXCALIBUR PARTNERS (NY)
TWA HOLDING PARTNERSHIP
ICAHN HOLDING CO. (DE)
CARL ICAHN
CARL C. ICAHN FOUNDATION (DE)
(Previously owned by ICAHN CAPITAL)
BRETT INVESTORS (DE)
(Previously WOLF INVESTORS PLAN INC. (NY)
ICAHN CAPITAL CO. (DE)
IAC ACQUISITION CORP.
ICAHN ACQUIS. CORP. (DE)
L.C. ACQUISITIONS CO. INC. (NJ)
(previously, ICAHN & COMPANY, INC.)
ICAHN & CO. INC. (NY)
HERON INV. PLAN INC. (CT)
BAYSWATER REALTY & CAPITAL CORP.
BAYSWATER CORP (DE)
CARDINAL INVESTORS CORP. (NY)
RIVERDALE INVESTORS PLAN
RIVERDALE INVESTORS CORP. INC. (DE)
BAYSWATER REALTY BROKERAGE CO.
AMBASSADOR CAPITAL CORP. (DE)
BAYSWATER ACQUISITION CORP. (NY)
CCI & ASSOC. LTD. P'SHIP (NY)
TWA
O'RIOLE CORP. INC.
ACF
MERGED
DISSOLVED
EXACT RELATIONSHIP UNKNOWN
OTHER PARTNERS
IDENTIFIABLE NON STOCK TRANSACTION

TWA.

WHO OWNS STOCK?


CARL C. ICAHN
ACF INDUSTRIES INC
CARL ICAHN
O'BRIEN CORP.
TWA HOLDING PARTNERSHIP
TWA ACQUISITION PARTNERSHIP (DE)
TWA INC.
(TRANS WORLD AIRLINES)
ACF SUBSIDIARIES
ACF CANADA (1985) LTD. CANADA
ACF INDUSTRIES, INC. DE
ACF LEASING CO DE
ACF SALES CORP DE
HEALTH INVESTORS LTD. PARTNERSHIP CT
O'BRIEN CORP. DE
TURTLE INVESTORS CORP NY
TWA SUBSIDIARIES
TRANS WORLD
COMPUTER SERV'S INC.
TWA GROUP INC.
TWA SERVICES
DISSOLVED
OTHER PARTNERS
EXACT RELATIONSHIP UNKNOWN

WHO CONTROLS TWA ?


I.C. HOLDING COMPANY, INC.
?
TWA
TEXACO
USX
VIACOM

The Air Line Pilots Association has submitted additional exhibits regarding S. 544. These exhibits can be viewed in the Senate Subcommittee on Antitrust, Monopolies and Business Rights, 308 Hart Senate Office Building

LAW OFFICES
BARRY ROBERTS
2828 PENNSYLVANIA AVENUE, N.W.
SUITE 307
WASHINGTON, D.C. 20007

BARRY ROBERTS
(D.C. & MD. BAR)
KATHLEEN O'REILLY
(D.C. & MD. BAR)

TELEPHONE: (202) 337-5290
FACSIMILE: (202) 337-5298

March 23, 1989

Mr. James J. Brudney
Chief Counsel
Labor Subcommittee
United States Senate
Committee on Labor
and Human Resources
608 Hart Senate Office Building
Washington, D.C. 20510

Re: S. 544 - Amendments to the Bankruptcy Code

Dear Mr. Brudney:

This office represents the Association of Retail Travel Agents, Ltd. ("ARTA"), a non-profit trade association comprised of approximately 3,500 travel agents and agencies throughout the United States. ARTA's members have a substantial interest in maintaining a healthy, reliable, and competitive air transportation system as they deal directly with the traveling public on behalf of air carriers and feel the most immediate impact from a major airline bankruptcy. Many travel agents have worked long hours in recent days to assist consumers in dealing with the problems caused by the Eastern Airlines bankruptcy.

Many travel agents become creditors of insolvent airlines. This can result from the operation of the airline industry's Area Settlement Plan ("ASP"). Under the ASP, travel agencies forward funds generated from ticket sales to a central clearinghouse for distribution to carrier airlines. In the event of a carrier bankruptcy, however, customers of travel agencies may not pay for tickets on the bankrupt carrier although the travel agent may have already advanced funds to the carrier under the ASP.

A travel agent can also become a creditor of an insolvent airline if customers request refunds for tickets purchased on a bankrupt carrier. The agent is then placed in the difficult position of either refusing the customers' requests, thereby losing the customers' business in the future, or providing the refunds and being unable to recover payment from the carrier.

In the current case of Eastern Airlines, many have raised concerns that important assets were sold or transferred from the Corporation to other Texas Air affiliates and that these changes left the carrier in a weaker position and contributed to its bankruptcy. Existing law covering fraudulent conveyances and preferences may not be adequate to cover situations where a shifting of assets among corporate affiliates contributes to a bankruptcy. S. 544 would require that whenever a common carrier goes into a Chapter 11 bankruptcy "every member of such carrier's controlled group of corporations shall simultaneously become a debtor under Chapter 11." We believe that this bill goes too far and that a more limited approach should be adopted.

In particular, we believe that the focus of attention should be on: (1) whether the corporate affiliates participated in the business of the bankrupt carrier, and (2) whether assets controlled by affiliates of the bankrupt carrier were actually used, shared, or jointly held. If it can be shown that either of these two factors occurred, the Bankruptcy Court should be required to expand the bankruptcy to include the participating affiliates. We feel that this case by case approach is a better response to the problem than the broad automatic inclusion of all affiliated companies contemplated by S. 544.

We also believe that Congress should give greater consideration to the interests of consumers in air carrier bankruptcies. Historically, business entrepreneurs and their lenders provided capital for business ventures and took the financial risk. In recent years however, a new pattern of capitalization has developed in the airline industry. Increasingly, airlines capitalize their operations through a variety of advance ticket sales devices. In many cases consumers pay for tickets months before the anticipated flight. Several carriers have recently announced programs where the public purchases the right to a specified number of flights for a twelve (12) or eighteen (18) month period. These pay-now-fly-later schemes are nothing more than loans from the public to the airline. If the airline goes into bankruptcy before the promised service is delivered, the hapless consumer becomes a general creditor of the airline.

If the airline offered notes or bonds to the public in exchange for these loans, they would be subject to state and federal securities laws. These laws generally require that the investor be fully apprised of the risk involved and the purpose to which the funds will be put. It is ironic that those who loan money to airlines and receive notes or bonds are generally more sophisticated and better able to absorb investment losses than consumers who may not understand that they are in fact making a loan to the carrier by purchasing advance tickets. We believe that airlines should obtain their financing in the more traditional capital markets and not lure consumers into financing their current operations with promises of future service that might not be provided.

The law has always treated common carriers differently from other business organizations, recognizing that they have a higher degree of responsibility and obligation to the public. When Continental Airlines, and later Air Florida, went into bankruptcy, ARTA intervened in the proceedings in an effort to have a trust impressed upon funds, held by those carriers, which represented advanced ticket sales. We were not successful. Consumers were treated as general creditors. We still believe the concept of putting consumers in a preferred position with respect to the recovery of money paid for future service is sound and should be considered as the basis for additional amendments to the Bankruptcy Code. To the extent that money can be identified as the proceeds from advanced ticket sales, such funds should be impressed with a statutory trust for the benefit of consumers. In addition, consumers should be placed in a preferred position ahead of other unsecured creditors with respect to claims on the bankrupt estate.

We would be pleased to assist the appropriate Congressional Committees in any way possible to develop meaningful legislation to protect consumers in the event of air carrier bankruptcy. We request that a copy of this letter be placed in the record of S. 544.

Sincerely yours,

Barry Roberts

Barry Roberts
Counsel to The Association
of Retail Travel Agents, Ltd.

cc: Mr. Ronald A. Santana
Mr. Sal De Pace

Transport Workers Union of America

Affiliated with American Federation of Labor and Congress of Industrial Organizations

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STATEMENT OF

JOHN J. KERRIGAN, DIRECTOR

AIR TRANSPORT DIVISION,

TRANSPORT WORKERS UNION OF AMERICA, AFL-CIO

BEFORE THE

COMMITTEE ON THE JUDICIARY

U.S. SENATE

March 17, 1989

S. 544

AMENDMENTS TO THE BANKRUPTCY CODE

Good morning. I am John J. Kerrigan, President of the Transport Workers Union of America, AFL-CIO. TWU represents some 50,000 airline employees throughout the industry, including mechanics, fleet service, flight attendants, dispatchers, and instructors. We hold bargaining rights on most major carriers including American, Pan American, Eastern, Northwest and Continental.

TWU support S.544 because we believe it provides much needed improvements in relation to the handling of Railway Labor Act collective bargaining agreements under the Bankruptcy Code.

To begin with, the bill gives airline employees the same protection as rail employees by making clear that our agreements cannot be altered in Chapter 11 proceedings except through the mechanisms described in Section 6 of the Railway Labor Act. Prior to the Continental bankruptcy it had, in fact, been our understanding that the Bankruptcy Code could not be used as a means for circumventing airline collective bargaining agreements. Unfortunately, in the Continental case the judiciary sanctioned the notion that airline agreements are entitled to less protection than rail agreements under the Bankruptcy Code--a construction of the statute which is not supported by the language of the Code or the RLA. The result has been the sort of chaos which we now see at Continental and Eastern. This result is directly inconsistent with the goal of the RLA--stability in the national transportation system.

S.544 also provides that all members of a "controlled group" are responsible for the debts of a subsidiary which seeks Chapter 11 protection. It does this by requiring the members of the controlled group, including parent holding companies and related subsidiaries, to enter bankruptcy if the air carrier does so. A similar principle has already been established in relation to the pension liabilities of a bankrupt member of a controlled group.

The simple justice of this amendment is clear. For example, Eastern Airlines, since being taken over by Texas

Air, has been required to pay an exorbitant "management fee" to its holding company. What it purchased was a management which created and implemented policies which led to industrial chaos and bankruptcy. However, the employees and creditors of Eastern, not Texas Air, are having to bear the costs of this mis-management. In short, this amendment shifts at least part of the liability where it belongs--to the entity which really controls the bankrupt subsidiary and in all likelihood, is ultimately responsible for its bankruptcy.

I commend the Committee for examining this problem. I regret that the continuing chaos in the industry brought on by deregulation compels such examination.

American Bankruptcy Institute
107 Second St. NE
Washington, D.C. 20002
(202) 543-1234

Analysis of S.544
March 14, 1989

Contact: Suzanne Bingham
Nancy Worth Davis

The American Bankruptcy Institute is an association of academicians, judges, practitioners and public policy makers who have professional interests in the field of bankruptcy law and practice, and particularly in the organization and efficiency of the nation's bankruptcy courts. ABI is a bi-partisan, non-profit educational Institute.

The ABI has been asked to review and comment upon S. 544, recently introduced by Senator Howard Metzenbaum, which would amend various provisions of the Bankruptcy Code in order to provide limits on the modification of collective bargaining agreements entered into between air carriers and their employees. In addition, the bill seeks to require that a subsidiary company may not file a bankruptcy case without the simultaneous filing of its parent, thereby making the assets of the parent available to the creditors of the subsidiary. This bill, if passed in its present form, would be retroactive as of the date proposed, March 8, 1989.

While ABI will not comment on the merit of this bill, we have analyzed its effect and will relate our findings.

Section One - Sec. 103(g) of Title 11, U.S.C

Section One of the bill proposes to bring any collective bargaining agreements subject to the Railway Labor Act under the protection of subchapter IV of Chapter 11 of the Bankruptcy Code. This subsection, which presently applies only to railroads, would be expanded at section 1167 to specifically include collective bargaining agreements of air carrier employees. At present, collective bargaining agreements of air carrier employees would be reviewed by a judge in a bankruptcy proceeding, who could approve changes made in accordance with the provisions of the Bankruptcy Code. The effect of this amendment is to legislate decisions concerning air carrier collective bargaining agreements and remove the authority to approve changes from the courts.

Section Two - Sec. 1113(a) of Title 11, U.S.C.

Section Two of the proposed bill seeks to explicitly restrict "debtors in possession" from assuming or rejecting collective bargaining agreements under section 1113 of the Bankruptcy Code.

Presently a "trustee" in a case covered by subchapter IV of Chapter 11 and by Title I of the Railway Labor Act is barred from use of Section 1113; Chapter IV relates to railroad reorganizations. The proposed bill would seek to extend this exception to explicitly include "debtors in possession." This amendment seems unnecessary since a trustee must be appointed in case under Chapter IV, and there can be no "debtor in possession" in such cases.

Section Three - Sec. 1167 of Title 11, U.S.C.

Section Three seeks to amend section 1167 of the Bankruptcy Code which prohibits the trustee and the Court from modifying collective bargaining agreements that are subject to the Railway Labor Act. The proposed bill would add "debtor in possession" to the enumerated parties affected by section 1167. As above, this amendment is unnecessary and serves to further the single interest of this legislation.

Section Four - Sec. 109 of Title 11, U.S.C.

Section Four proposes a significant change in the present bankruptcy law, which could set an undesirable precedent. The bill seeks to amend the Bankruptcy Code definition of who may be a debtor, as provided at section 109(a) of Title 11, by requiring that an air carrier may not file a bankruptcy unless each member of that air carrier's "controlled group" also files a bankruptcy case and the assets of all are made available to the creditors of each. The effect would be to make a parent company responsible for the debts of its subsidiaries, and make each subsidiary responsible for the debts of the other subsidiaries. This violates the concept of the separateness of corporations and sets a precedent which could have undesirable economic consequences. Thus, while making the assets of other subsidiaries available to pay the debts of the bankrupt subsidiary could benefit that subsidiary's creditors, it would be done at the expense of the creditors of the non-bankrupt subsidiary.

Existing law already protects creditors of a bankrupt company if there has been a transfer of assets without adequate consideration. This protection can be achieved by an application of existing provisions of the Bankruptcy Code which permit recovery of assets of a debtor corporation which have been fraudulently transferred.

Section Five - Retroactive Amendment

Section Five of the proposed act would become effective retroactively on the date it was proposed, March 8, 1989. While tax legislation is commonly made retroactive to its proposed date, in order to prevent evasion of the legislation, it is not usual in bankruptcy legislation to give retroactive effect to a bill. This would again create an undesirable precedent and as noted in Section Four above, would affect a material charge as to existing law on corporate transactions. Both Sections Four and Five substantial constitutional questions meriting careful study and examination.

Conclusion

Section One - Section 103(g) of Title 11, U.S.C.

This proposed amendment to the Bankruptcy Code would legislate decisions concerning air carrier collective bargaining agreements and remove decision making from the Courts, where it is presently vested as a result of the 1984 Amendments to the Bankruptcy Code.

Section Two - Section 1113(a) of Title 11, U.S.C

This amendment is unnecessary and serves only to further the single interest of this legislation.

Section Three - Section 1167 of Title 11, U.S.C.

This section is technically necessary only to further the single interest of this legislation.

Section Four - Section 109(d) of Title 11, U.S.C.

This amendment violates the principle of separateness of corporations and could have far-reaching precedential effect. Reasonable protections exist now in the Bankruptcy Code.

Section Five - Retroactive Application

This effect would be an undesirable precedent in the bankruptcy context.

This bill, which seeks to amend the Bankruptcy Code, may have undesirable consequences. To the extent that the bill is aimed at protecting creditors from transfers of assets among related corporations, the objectives of the bill can be met by application of presently enacted bankruptcy laws as judicially interpreted. To the extent that the bill aims at protecting collective bargaining agreements, the Bankruptcy Code, as amended in 1984, provides for judicial review of collective bargaining agreements. The bill raises substantial constitutional questions and reverses assumptions upon which related corporations presently transact business. Careful examination of the economic effects and constitutional implications of this bill should be undertaken.

Statement Of The
ASSOCIATION OF FORMER BANKRUPTCY JUDGES

In Respect to S.544

For Inclusion Into The Record of
Senate Judiciary Committee Hearings

March 23, 1989

STATEMENT OF ROBERT J. SIDMAN
PRESIDENT OF THE ASSOCIATION OF FORMER BANKRUPTCY JUDGES

In Respect to S.544

March 22, 1989

Mr. Chairman and Members of the Subcommittee:

My name is Robert J. Sidman, and I am currently President of the Association of Former Bankruptcy Judges ("AFBJ"). The AFBJ consists of a nationwide group of individuals who have had the privilege of serving as bankruptcy judges and who, after the end of their judicial careers, have voluntarily associated in this non-profit association in order to promote the continued viability and integrity of the bankruptcy court system. The AFBJ was initially formed in 1983 to address the jurisdictional problems created by the Supreme Court's decision in Marathon Pipeline. The AFBJ has, from time to time since 1983, taken positions with respect to either pending legislation, or litigated matters of substantial general interest to the bankruptcy process, for the purpose of fostering the goal of improving the system of bankruptcy laws. The AFBJ represents the only group whose members bring both the judicial and practitioners' perspective of bankruptcy practice into focus. The members of the AFBJ collectively have had literally hundreds of years of judicial and practice experience with which to formulate and judge the merits of any bankruptcy-related matter. This Statement is made on behalf of the AFBJ in opposition to S.544 for the reason that the adoption of S.544 without a deliberate consideration of the merits of the proposed changes to the Bankruptcy Code (and their effect on the bankruptcy remedy) is unwise.

Congress, in accordance with the mandate of our Constitution, has passed numerous laws governing bankruptcy in the United States. Bankruptcy laws have been historically passed by Congress only infrequently, and only after long and reasoned debate over the wisdom of any proposed legislation. S.544 transforms the usual deliberate and informed legislative process into a "quick fix" remedy which has many dangerous and unwise ramifications.

Not surprisingly, various interest groups have formulated positions with respect to S.544. The unions, and their supporters, are clearly in favor of the legislation, and Eastern Airlines has opposed the legislation. In preparing this Statement, we have had the privilege of reviewing a number of the statements made before the Committee on March 17, 1989. One thing is clear from these statements -- no one disputes that Eastern Airlines is in severe financial difficulty, and that central fact (whether the financial problems are caused by deregulation, management errors, or union demands is immaterial) mandates that Eastern Airlines have the opportunity to address those financial problems in a single forum for the benefit of all parties in interest, including its employees, its creditors and its shareholders.

S.544, which can be easily described as private legislation designed for the benefit of Eastern's unions, provides several unwise roadblocks to Eastern's financial rehabilitation. S.544 also represents an extreme form of legislative intrusion into the judicial process.

Many serious allegations are made by the proponents of S.544 that Eastern's assets have been "upstreamed" to its parent, Texas Air Corporation, or have otherwise been placed beyond the reach of Eastern's creditors. No one has suggested that the present legislative structure of the Bankruptcy Code is incapable of dealing with those transfers, if they indeed did occur. In fact, the filing of a bankruptcy petition invites close judicial scrutiny of Eastern's pre-filing conduct and gives the creditors and employees of Eastern the best possible opportunity to examine all of the financial dealings of Eastern, whether they involve Texas Air, Continental Airlines or any other entity. In many respects the Chapter 11 filing by Eastern will operate much less as a "haven from creditors" as it will as a public forum for the most intense scrutiny of Eastern's financial condition as can be imagined.

The point of this Statement is quite simple. Congress has spent many years structuring an integrated bankruptcy law system which, though not perfect, has provided the American business community and the consumer public with a vehicle for addressing financial stress. A recent and quite dramatic example of the benefit of the bankruptcy law system is evidenced in the successful Chapter 11 reorganization of Texaco. There are very few who would disagree with the benefit provided by that reorganization.

There may well be changes necessary to make the bankruptcy laws of the United States better address the complex financial problems presented by modern day economic realities. However, those changes should take place in a reasoned and deliberate process of open debate. The quick and ill-considered passage of S.544 would mistakenly replace such reasoned debate with the hysteria of the moment. It would be unwise, detrimental to the bankruptcy system and, probably unconstitutional, for S.544 to be passed in such a fashion. The AFBJ urges rejection of S.544 at this time, pending a full airing of the wisdom of this legislation, and its many ramifications, both intended and accidental. The delicate balance of the bankruptcy process as evidenced by current law is far too important to jeopardize with hastily-passed piecemeal legislation.

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March 28, 1989

Honorable Joseph R. Biden, Jr.
Chairman, United States Senate
Committee on the Judiciary
Dirksen Senate Office Building
Room 224
Washington, D.C. 20510

My Dear Mr. Chairman:

On behalf of our client, the Commercial Law League of America ("CLLA"), we respectfully request additional hearings on S. 544. CLLA is composed of over 6,000 members throughout the United States and Canada, the majority of whom are attorneys, judges, U.S. trustees, and educators engaged in or with a particular interest in, the practice of commercial law, including the practice of bankruptcy, corporate re-organization and other creditors "rights" matters.

Senate Bill 544 represents a major substantive amendment to the Bankruptcy Code. Therefore, it would appear that the Judiciary Committee has not availed itself of the benefits that would have been provided if comments from many of the major organizations representing interests that would be seriously impacted by S. 544 had been solicited.

Including the Commercial Law League of America, your Committee could solicit comment and testimony from the American Bankers Association, National Commercial Finance Association, the Executive Office of the U.S. Trustee, National Conference of Bankruptcy Judges, National Association of Credit Management, the National Bankruptcy Conference, the Business Law Section of the American Bar Association, the Association of Insolvency Accountants, the Airline Passenger Association and the American Society of Travel Agents.

Honorable Joseph R. Biden, Jr.
March 28, 1989

Confident that your Committee will want to have all relevant evidence before it, and that additional hearings on S. 544 will be ordered, I am,

Very truly yours,

Burkett Van Kirk

Burkett Van Kirk

BVK:dla

P.S. For the current record on S. 544, I am enclosing the CLLA Position Paper on that legislation.

CLLA®

COMMERCIAL LAW LEAGUE OF AMERICA®

JOHN J. McLAUGHLIN
President

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POSITION PAPER ON S. 544

Presented by the
Commercial Law League of America

This written statement of position is presented by the Commercial Law League of America ("CLLA"), a national organization of attorneys and others actively engaged in the fields of commercial law, bankruptcy and reorganization.

It is the publisher of the prestigious Commercial Law Journal and Commercial Law Bulletin. One of its constituencies is the Bankruptcy and Insolvency Section whose membership consists soley of attorneys who practice bankruptcy law and who are involved in many significant bankruptcy cases thoughout the United States including LTV, Manville, Robin, Revco, Braniff, Bildisco and Marathon.

The CLLA has long been associated with the representation of creditor interests

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that is well known and respected throughout the country. The CLLA has testified before Congress on numerous occasions as experts in the bankruptcy and reorganization field.

In general, while we perceive that S. 544 is intended to correct a serious inequity, we believe that there is a danger in dealing with substantive amendments to the Bankruptcy Code in reaction to a perceived problem in particular case without an opportunity for deliberate study on the impact of proposed legislation on other well founded legal doctrines and principles in and out of bankruptcy.

Turning first to the specific issue relating to the proposed amendments of §1113 and §1167, we submit that §1113 of the Bankruptcy Code (the "Code") clearly sets forth several conditions precedent and delineates the circumstances under which a bankruptcy judge may allow the modification or abrogation of collective bargaining agreements. This section of the Code was enacted partially in response to In re Bildisco, the Supreme Court's interpretation of the 1978 Act relating to the test for rejection of labor agreements.

It should be noted that §1113 has not been subject to the same degree of controversy and the case law that has evolved subsequent to its enactment in 1984 has met with general approval by creditor groups, labor unions and debtors alike.

It is submitted that Senate Bill 544 would have the effect of dismantling, at least insofar as the airline industry is concerned, the well reasoned approach of §1113. It would be a dangerous precedent to carve out exceptions in the Code for particular industries merely because their positions were popular at the moment or as the result of a vocal constituency.

The major feature of S. 544 as introduced by Senator Metzenbaum and as detailed in his opening statement, is to protect a substantial segment of consumers who are left in the unfortunate position of holding non-negotiable tickets which are not immediately redeemable or transferable in a Chapter 11 case.

Senator Metzenbaum's remarks at the March 17, 1989, hearing before the Judiciary Committee on proposed S. 544, is a particularly poignant plea for the protection of unwary ticketholders which we share.

To address the first concern of Senator Metzenbaum, it is our considered opinion that any alleged inter-corporate abuses or related entity transfers of property are subject to the careful and public scrutiny of the Bankruptcy Court. With all due respect to the remarks of Professor Eisenberg of Cornell University Law School, we submit that the Bankrutpcy Court, as a court of equity jurisdiction, has the power to correct abuses regardless of whether or not they are readily pigeonholed into specific bankruptcy causes of action, e.g., insider transfers, preferences, fraudulent transfers, turnovers or equitable subordination.

The Bankruptcy Court is well known for its ability to tailor a remedy to prevent unjust enrichment by any party whether related or not to the debtor. Transactions by and between related corporate entities have always been subject to special scrutiny and the courts have been zealous in finding ways to protect the rights of aggrieved parties.

Addressing Senator Metzenbaum's concerns for the consumer, under existing law, ticketholders may have an advantageous position as a priority deposit creditor pursuant to §507a(6) of the Code.

In an analogous situation, while there is no formal mechanism for the payment of pre-petition wage claims, it is a common practice for a bankruptcy court to entertain and act promptly on applications for expedited payment of wage priority claims in order to prevent hardship to wage earners who depend on their weekly paychecks to support their families and to otherwise provide an atmosphere for re-establishment of employee morale which is essential for the successful rehabilitation of any Chapter 11 debtor.

We believe that the impact on other constituencies in a bankruptcy case by the payment of these wage or ticketholder claims would be, in most instances, minimal. The payment of pre-petition airline ticketholder claims should not be objectionable to other unsecured creditors as such payments would promote the preservation of the entity's goodwill which is essential, particularly in the airline industry.

The redemption of tickets may not, in fact, result in a cash drain if a mechanism is formulated to encourage ticketholders to use old tickets, particularly if merchandising incentives are incorporated into the redemption process.

It is not uncommon for attorneys and other functionaries in bankruptcy cases to fashion pragmatic solutions to these troublesome problems similar to the ones S. 544 attempts to address.

The sheer expense and complexity of major Chapter 11 cases today is in itself, an issue which must be addressed by numerous entities, including the Bankruptcy Bar, the Judiciary and the Justice Department, even without any additional burden upon the system, which whould be created by the proposed law.

Although ticketholders have certainly been affected by Eastern's Chapter 11 filing, just imagine the proliferation of ticketholder claims in the event that Continental, Texas Air and their subsidiaries were subjected to the same delay and inconvenience which automatically occurs upon the filing of a Chapter 11 case. Indeed, the entire Bankruptcy Code would have to be amended to provide a mechanism to prevent the near certain chaos that would be created by the simultaneous filing of entities whose creditors may well number in the millions.

Some thought should also be given to the fact that the additional administrative and judicial caseload that would result with the passage of S. 544 will necessitate the delay of justice for thousands of other individuals and entities whose rights are dealt with daily by the Bankruptcy Court system. Is Congress prepared to increase the number of bankruptcy judges and other administrative personnel in order to accommodate its judicial fiat in this instance? In fact, the only guaranteed benefit of much of that proposed in S. 544 is the geometric increase in business available to bankruptcy practitioners.

There are several other issues which were reviewed in other position papers or that were presented at the recent hearing that merit comment.

It has been our observation that debtors rarely file Chapter 11 cases as an instrument to abrogate union collection bargaining agreements. Certainly the provisions of §1113 which provide specific guidelines to the Bankruptcy Court makes it virtually impossible to reject an agreement without cause. Second, the Bankruptcy Code has a built-in safety valve for those who might insidiously attempt to terminate a labor contract by the utilization of Chapter 11. Under the good faith doctrine as set forth in the Code, the Bankruptcy Court can preliminarily determine whether a particular debtor is impermissably using the bankruptcy law for a singular purpose which would constitute the initial threshold qualification for relief.

Further, Congress should at least provide an opportunity to see if the mechanisms it provided in §1113 work within the framework of a major Chapter 11 case such as Eastern. Afterall, the judge's determination to allow Continental to abrogate its collective bargaining agreement had its underpinnings on judicial precedent and not on the standards as subsequently promulgated in §1113. Even though it can be argued that §1113 was a response to a unique set of circumstances and as such required substantive changes to the Code, (much like the arguments now being made in support of S. 544), it is important to keep in mind that §1113 was enacted only after clear evidence that the then existing system did not work effectively. There is no such similar evidence in the current situation and §1113, enacted only after such study and hearings, should be allowed to work.

The provision in S. 544 requiring substantive consolidation raises the spectre of a serious constitutional challenge. As noted elsewhere, substantive consolidation has traditionally been a term of art in bankruptcy cases.

Traditionally, substantive consolidation provides an umbrella approach to related cases by providing for the pooling of all assets and liabilities of more than one entity and ordering distribution on a pro rata basis. It is used sparingly and for good reason. The guidelines for invocation of substantive consolidation are rigorous and require "piercing the corporate veil" and usually involve a commingling of assets and a disregard of the usual corporate formalities. To our knowledge, the doctrine of substantive consolidation has never been invoked for an entity that was not already subject to bankruptcy court jurisdiction.

This doctrine's expansion to a healthy company in a bankruptcy context might very well be tantamount to a taking of property without due process. We wonder whether it is constitutional to utilize the assets of a solvent entity to pay the debts of another financial troubled company.

Furthermore, it is submitted that the enactment of S. 544 might well have a chilling effect on future airline growth and ultimately will serve to lessen competition in an industry that is fast becoming controlled by a few strong carriers. Such a restraint on competition would have a negative impact on the consuming public.

Finally, it appears from the statements of the proponents of S. 544 that the real disease is the deregulation of the airlines and that the problems S. 544 attempts to address are merely symptoms.

Glaringly, it appears that the Judiciary Committee did not avail itself of the benefits that could have been provided had comments from many of the major organizations representing interests that would be seriously impacted by S. 544 been solicited.

Including the Commercial Law League of America, comment and testimony should be solicited from the American Bankers Association, National Commercial Finance Association, the Executive Office of the U.S. Trustee, National Conference of Bankruptcy Judges, National Association of Credit Management, the National Bankruptcy Conference, the Business Law Section of the American

Bar Association, the Association of Insolvency Accountants, the Airline Passenger Association and the American Society of Travel Agents. Evidence thus gained would at least allow Congress to make a decision based on all of the facts, not just on a minuscule portion.

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March 9, 1989

Senator Howard Metzenbaum
Senate Office Building
Washington, D. C. 20510

The Senator Metzenbaum:

The 6000 members of the Retired Airline Pilots Association strongly supports your legislation to prevent Mr. Frank Lorenzo from sucking up all the tangible assets from Eastern Air Lines and ensure protection of Eastern Air Lines creditors and employees assets.

The legislation to prevent all airlines from unilaterally changing employee compensation and working conditions is a necessary provision under bankruptcy conditions.

You have RAPA's one hundred per cent support during these trying times in the airline industry. I would appreciate a copy of your bill.

Good luck and happy landings.

Sincerely yours,

John Stefanki

John X Stefanki
RAPA Legislative Vice President

SUPPLEMENT TO TESTIMONY
of
L. E. Creel, III

Following the conclusion of testimony on March 17, 1989, before the Senate Judiciary Committee, the record concerning S.544 was left open for additional comments. I have these:

1. "Special Interest" Legislation Unnecessarily Aborts Section 1113. The format of the hearing, the carefully prepared testimony of the pro-union witnesses and the obvious favorable bias in favor of the two unions' position suggested the transpancy of an attempt to quickly legislate potentially-destructive provisions for a "special interest" group without the careful thought or the availability of opposing positions that should be required before aborting Section 1113 of the Bankruptcy Code, the Bankruptcy Code section carefully crafted and enacted on July 10, 1984, just over four years ago for the specific purpose of dealing with this same collective bargaining issue in a bankruptcy context.

2. The "Status Quo" of the Railway Labor Act Is Not "Status Quo"; It is Union Victory. Before legislatively destroying the flexibility of a bankruptcy court to fashion those alternatives frequently required for business survival in connection with such vital issues as collective bargaining and substantive consolidation, alternatives based upon credible admissible evidence (not the Wall Street Journal or the opinions of union antagonists), Congress should carefully examine drastic changes in bankruptcy law like S.544 in the

light of readily available empirical and experiential data. For example, before relegating the collective bargaining process for airlines to the inflexible "status quo" of Section 6 of the Railway Labor Act, a review of prior experience under that process and its effect on the decline of the nation's railway systems should be compared to the successes available as a result of today's modern bankruptcy system.

More importantly "status quo" isn't really "status quo." It is at least a short term victory for the party who benefits by forcing ongoing benefits during lengthy and potentially fatal discussions of change. If the number of employees, their functions and their pay scales are set in concrete during the "status quo," and if there is no present cash to support the attendant costs, the then enterprise must necessarily fail in the short term. However, if there is flexibility, all parties can be accommodated until long range solutions can be found.

It is a fact that the flexibilities encouraged by the bankruptcy system can work for a troubled airline. For example, Continental Airlines did reorganize; it is flying today and it does employ thousands of people.

3. Substantive Consolidation to Recover Assets Is Legislative Overkill. A distinction needs to be made between the short term basic survival needs of troubled businesses which the courts can fashion and the long term use of existing remedies to recover assets improperly transferred. To arbitrarily require substantive consolidation of minority-

controlled "affiliates" at the beginning of a case in order to simply recover allegedly transferred assets may well overwhelm basic survival needs and kill an already diseased patient by bringing in more debt, more complexity and more diverse interests than can be dealt with in a critical business environment. Since the stated, but limited, purpose of the amendment to Section 109 of the Bankruptcy Code is to gather, by legislative fiat, Eastern's prior assets which are suspected to have been unfairly transferred to others (but as to which transfers there presently exists in this record only subjective opinion gathered from newspaper and other non-evidentiary sources), it seems that the proposed legislation requiring substantive consolidation to accomplish that purpose is an example of unnecessary overkill. Just because some parties believe that Eastern Airlines may have been stripped of assets, does not mean that all future airline companies and all companies related to all of them should be forced into substantive consolidation without a hearing and without a showing, based upon evidence and existing legal precedent, that such consolidation is appropriate.

The issue here is the effect of alleged improper transfers. The proposed legislative cure employs the unnecessarily far-reaching concept of substantive consolidation, with its many ramifications. If transfers were improperly made, numerous legal devices, based upon centuries of precedent, already exist to fully remedy any targeted demonstrable wrongs. There is simply no justification for forcing future, healthy companies into bankruptcy because an affiliated airline may have financial difficulty. Even more strongly, neither union interests (a limited "special interest" group), nor any other interests, should be able to so drastically affect the future and unknown rights of others, simply because those interests are presently unhappy about the way a limited labor-management dispute is being handled in a particular case.

4. S.544 Is Probably Unconstitutional. S.544 is probably unconstitutional because:

   a. It violates the Constitutional *ex post facto* principle, by conscious design. For its supporters to suggest that S.544 is a generic approach to a long-standing and typical business problem is an affront to the intelligence of those who oppose it. S.544 appears to be specifically created to assist the two unions who appeared before th Judiciary Committees in their ongoing war with Frank Lorenzo and Eastern Airlines. The fact that its retroactive date coincides with the day before Eastern's Chapter 11 filing is no coincidence. There is no "legitimate legislative purpose" for this bill; there is no "uniformity" among business needs; there are no general public policy needs; there is no basic fairness or appropriate prior warning. The very reason that the Constitution requires that the rules do not change in the middle of the game is the reason why this law should not be enforceable.

It has been suggested that tax legislation is sometimes retroactive, and that, therefore, retroactivity is permissible with respect to S.544. Tax legislation does not relate to private rights between private parties; it deals with the rights of a sovereign to tax its citizens. Apples are not oranges.

b. S.544, in fact, legislatively determines matters presently in controversy in a pending court case. The proposed law, thus, seems to violate the principle that the powers of the branches of government must be separated.

c. By forcing the substantive consolidation of outside corporations into an airline reorganization, S.544 may well violate the principles of "due process" because the property rights of others can, and will, be adversely affected.

Careful Constitutional analysis, within a reasonable time frame which will insure reasoned thoughtfulness, should precede consideration of this legislation.

Amending existing bankruptcy law cannot cure economic problems. It cannot create cash or equity value; it cannot provide jobs; it cannot change the market place. This legislation will not insure that Eastern Airlines' employees will work tomorrow or, if working, be paid. In order for Eastern Airlines, or any other business, to have the opportunity to reorganize, there must be a bankruptcy system that permits all interested parties to gather, to argue and persuade, to negotiate, to seek viable business alternatives, and, in the final analysis, to permit a bankruptcy judge, after hearing from all of them, to quickly rule, as often and as narrowly, as needed. S.544 frustrates that basic bankruptcy premise by carving out a particular problem in a particular industry at a particular time, without a careful weighing of long-term consequence.

On behalf of the American Bankruptcy Institute, I urge the Committee not to act hastily, to gather more evidence and then, when the legislation and its effects are fully understood, if changes are clearly required, propose them. The ABI, as always, stands ready to assist any member of the Committee in gathering any information which may be useful and in making available input from diverse sources.

Personally, as a bankruptcy practitioner who has been heavily involved in the bankruptcy system for 25 years, I oppose S.544.

I appreciate the opportunity to add these remarks to my prior testimony.

LE Creel

L. E. Creel, III
March 27, 1989
Dallas, Texas

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